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THE LEGALITY OF EXCHANGE RATE UNDERVALUATION UNDER WTO LAW[1]

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[1] This memorandum is a research paper prepared on a pro bono basis by students at the Graduate Institute of International and Development Studies (IHEID) in Geneva. It is a pedagogical exercise to train students in the practice of international trade law or international investment law, not professional legal advice. As a result, this memorandum cannot in any way bind, or lead to any form of liability or responsibility for, its authors, the supervisors of the IHEID trade law clinic or the Graduate Institute.

INDEX

I. GLOSSARY OF TERMS 1

II. EXECUTIVE SUMMARY 3

III. INTRODUCTION 6

IV. BACKGROUND INFORMATION 8

A. CURRENCY UNDERVALUATION HAS THE ECONOMIC CONSEQUENCES OF A BARRIER TO TRADE 8

B. ALTHOUGH NEITHER THE WTO NOR THE IMF HAVE RULED ON CURRENCY UNDERVALUATION, THE WTO IS THE MORE RELEVANT FORUM TO PURSUE SUCH A CLAIM 10

C. THE GATT RULES ARE UNCLEAR ON CURRENCY UNDERVALUATION BECAUSE THEY WERE WRITTEN FOR AN INTERNATIONAL MONETARY REIME THAT HAS SINCE PASSED 11

V. OFFENSIVE LEGAL ACTION 14

A. AN UNDERVALUED RMB UNDERMINES CHINA'S TARRIF CONCESSIONS, BUT PROBABLY DOES NOT VIOLATE GATT ARTICLE II 14

1. Overview 14
2. GATT Article II:1 (a) and (b) 14

a) Currency undervaluation is not a de jure violation of GATT Article II:1 (b), first sentence 15

b) Currency undervaluation may de facto violate GATT Article II:1 (b), 1st sentence 15

c) Currency undervaluation may violate GATT Article II:1 (a) 16

3. GATT Article II:3 18

a) "method of...converting currencies." 19

b) Alteration of the method of converting currencies 21

4. GATT Article II:6 22
5. Conclusion 24

B. A CLAIM UNDER GATT ARTICLE XV COULD BE ATTEMPTED, INASMUCH AS THE INTENT OF ANOTHER SPECIFIC GATT OBLIGATION IS BREACHED 25

1. Overview 25
2. Article XV:2 26
3. IMF Articles of Agreement 27
4. Article XV:9 29
5. Article XV:4 30

a) "Exchange Action" 30

b) "Frustrate the Intent" 32

6. Conclusion 34

C. A CLAIM ON GATT ARTICLE XXIII:1 (B) IS LIKELY TO BE SUCCESSFUL AS THE COMBINATION OF PEGGING AND BUYING US SECURITIES NULLIFIES OR IMPAIRS LEGITIMATE MARKET ACCESS EXPECTATIONS .36
1. Applicability and Relationship with GATT Article XV 36
2. "Measure" 38
3. "Benefit" 38
4. Legitimate Expectations 38
a) Expecting a "Single and Managed Floating Exchange Rate" 39
b) Expecting an Appreciation 40
5. "Nullification or Impairment of the Benefit by the Measure" 42
6. De minimis Contribution to Nullification or Impairment 42
7. No Intent necessary 43
8. Conclusion 43
D. IT IS UNLIKELY THAT THE CHINESE EXCHANGE RATE POLICY AMOUNTS TO A PROHIBITED OR ACTIONABLE SUBSIDY 44
1. Financial Contribution 44
a) SCM Article 1.1 (a) (i) 45
b) SCM Article 1.1 (a) (iii) 47
c) SCM Article 1.1 (a) (iv) 48
d) Partial Conclusion 48
2. Benefit 49
a) Domestic Market Comparison 49
b) Utilization of Benchmarks other than in the Country of Provision 50
(1) SCM Article 14 (d) and Article 15 (b) of the Protocol of Accession 50
(2) Rejection and Reconstruction of the USD-RMB exchange rate 52
(3) Partial Conclusion 53
3. Prohibited Subsidies 53
a) Illustrative Subsidy of Annex I to the SCM 54
b) De Facto Export Subsidy 55
4. Actionable Subsidy 57
a) Specificity 57
b) Adverse Effects 57
(1) Injury to the domestic Industry 57
(2) Nullification or Impairment..60
(3) Serious Prejudice..61
(a) First option – Showing Displacement or Impediment of the Imports into the Market of the subsidizing Member 62
(b) Second Option – Showing Displacement or Impediment of the Exports from a third Country Market 62
(c) Third Option – Showing significant Price Effects or Lost Sales 63
(d) Fourth Option – Showing an Increase in World Market Share........................64
c) Partial Conclusion 65
5. Conclusion 65
VI. DEFENSIVE MEASURES 66
A. IMPOSING COUNTERVAILING DUTIES ARE LIKELY TO BE ILLEGAL UNDER WTO LAW DUE TO DIFFICULTIES IN FINDING A PROHIBITED OR ACTIONABLE SUBSIDY 67
1. Specific Subsidy 67
2. Injury 67
3. Causation 68
4. Practical Considerations on Implementation 69

5. Conclusion ... 69

B. ANTIDUMPING MEASURES ARE DEFENDABLE, ALTHOUGH THE OUTCOME OF A CHALLENGE ON THIS ISSUE IS VERY DIFFICULT TO FORESEE ... 70

1. Overview ... 70
2. Establishing Dumping ... 71
3. Normal Value ... 71
4. Non-Market Economies ... 71
5. Calculating the Dumping Margin ... 73
   a) Adjustment of Values 73
   b) Currency Conversions 74
6. Determination of Injury ... 76
7. Threat of Material Injury ... 77
8. Causal Link ... 77
9. Practical Considerations on Implementation ... 78
10. Conclusion ... 78

C. THE VALUATIONS AGREEMENT CANNOT REMEDY AN UNDERVALUED RMB UNLESS A NEW RMB-TARGETED EXCHANGE RATE IS UNDERTAKEN, WHICH IS OF DUBIOUS LEGALITY ... 80

1. Overview ... 80
2. The Intent of GATT Article VII and CV ... 81
3. GATT Article VII:4 and CV Article 9.1 ... 82
   a) Calculating Customs Value 82
   b) Right to Implement a New RMB-Real Exchange Rate 85
4. Conclusion ... 86

D. IMPOSING SAFEGUARDS BASED ON CHINA'S PROTOCOL OF ACCESSION MIGHT BE A STRATEGIC SOLUTION ... 87

1. General Concept ... 87
2. Accession Protocol ... 87
3. Temporary Scope of Application ... 89
4. Conclusion ... 90

VII. IMPACT ANALYSIS ... 91

A. OFFENSIVE ACTIONS ... 91

B. DEFENSIVE ACTIONS ... 92

1. Countervailing Measures ... 92
2. Antidumping ... 92
3. Customs Valuation Agreement ... 93
4. Safeguards ... 94

VIII. CONCLUSION ... 95

IX. BIBLIOGRAPHY ... 98

A. BOOKS AND ARTICLES ... 98

B. OTHER INSTRUMENTS ... 102

I. GLOSSARY OF TERMS

AB	The Appellate Body, standing body of the World Trade Organization, established under the terms of Article 17 of the DSU.
ADA	The Anti-Dumping Agreement
Brazil	The Federative Republic of Brazil
CV	The Customs Valuation Agreement
China or PRC	The People's Republic of China
DSU	The Understanding on the Rules and Procedures Governing the Settlement of Disputes (Annex 2 to the WTO Agreement)
FGV	Getúlio Vargas Foundation or Fundação Getúlio Vargas
GATT	The 1947 General Agreement on Tariffs and Trade
GATT 1994	GATT as Annexed to the WTO Agreement
IHEID	The Graduate Institute of International and Development Studies
IMF, or Fund	The International Monetary Fund
IMF Articles	The Articles of Agreement of the International Monetary Fund
IMF Article	A specific provision of the IMF Articles
Panel, or WTO Panel	Collegiate bodies established for the settlement of WTO disputes, under the terms of DSU Articles 7 – 14
Real	Real – The Official Currency of the Federative Republic of Brazil
RMB, or Yuan	Renminbi or Yuan – The official currency of the People's Republic of

	China
SCM	Subsidies and Countervailing Duties Agreement
US	The United States of America
USD, or Dollar	The American Dollar, the official currency of the United States of America
WTO	The World Trade Organization
WTO Agreement or Marrakesh Agreement	The Marrakesh Agreement Establishing the World Trade Organization

II. EXECUTIVE SUMMARY

This memorandum is the result of a request submitted by the Center on Global Trade and Investment of the Getúlio Vargas Foundation (FGV) in Brazil in the framework of the Trade Law Clinic at the Graduate Institute of International and Development Studies, Geneva. The following questions concerning primarily the legal effects, under international trade law, of exchange rate policies aimed at currency undervaluation, were posed by the client:

(i) Under what legal basis could a claim against a country practicing exchange-rate devaluation be argued within the WTO Dispute Settlement Body?

(ii) Which trade remedies could a developing country impose against a WTO member that practices exchange-rate devaluation?

(iii) Which form of legal action would be more effective against a WTO member that practices exchange-rate devaluation?

In analyzing the questions above and as instructed by the client, this paper presupposes that (a) the hypothetical dispute at hand would involve a developing country as claimant and the People's Republic of China as respondent; and (b) China's currency, the RMB, is kept, by government policy, at a value 25% below what its free float-exchange rate would be. Nevertheless, it should be kept in mind that calculating an exact level of over or under-valuation is an extremely difficult task, and this paper presupposes 25% undervaluation based on our client's suggestion. Whether the RMB is actually undervalued by 25% is not a question we answer here, but rather one we leave to economists.

With regard to potential offensive legal action in the sense of challenging the exchange rate action before of a WTO Panel this paper examines, whether a policy of undervaluation violates Articles II, XV, XXIII of the General Agreement on Tariffs and Trade and/or it constitutes a prohibited subsidy or actionable subsidy under to the Subsidies and Countervailing Measures. This memorandum concludes that such a measure could indeed be contrary to the provisions of GATT Article XV or GATT Article XXIII.

The decisive factor in determining which norm is violated is the interpretation of "exchange action" under GATT Article XV:4. If "exchange action" is found to comprise exchange rate policies aiming at undervaluing the domestic currency – as it is argued in this paper - then it might breach Article XV inasmuch as the 'intent' of another GATT obligation is found to have been frustrated, otherwise GATT Article XXIII. However, according to the findings in this study a currency undervaluation is unlikely to amount to a breach of the SCM. A very broad understanding of financial contribution would be a necessary condition to find a subsidy. In the event that this can be achieved this memorandum finds the elements of an export subsidy are likely to be fulfilled, whereas we find that this is improbable in relation to an actionable subsidy. Finally, it is unclear whether currency undervaluation amounts to a breach of GATT Article II—if so, it would only do so on a *de facto* basis, not on a *de jure* basis.

Concerning the ability to pursue defensive legal action under WTO law it is examined, whether a developing country could impose countervailing duties, anti-dumping duties or amend its customs valuations methods so as to compensate for the manipulated currency. In line with the arguments that speak against a subsidy it is found that imposing countervailing duties would most likely represent illegal action under the SCM agreement. With regard to anti-dumping duties the economic uncertainties involved in calculating the "normal value" make a clear-cut answer difficult. However, case law allows for wide discretion, which is why this paper concludes that anti-dumping duties might offer scope to address certain issues pertaining to monetary devaluation under WTO law. With regard to the CV agreement, this paper concludes that a state could not amend its method of customs valuation to compensate for RMB undervaluation unless this very state took the drastic action of pegging its own currency against the RMB. Furthermore, considering the specific case of China, this paper approaches the possibility of imposing safeguards on the term of China's Protocol of Accession to the WTO as a viable option for a country whose industries have been affected

Due to the complete absence of jurisprudence on this specific matter, the findings in this memorandum are mostly based upon legal interpretation methods and doctrine. Most importantly, the present analysis depends on macro-economic assumptions that need to be verified before any legal action is carried out.

General Advise, if legal action is sought[2]:

With regard to the potential offensive action discussed in this memorandum we find that the most reasonable claim would be based on GATT Article XV:4 together with GATT Article XXIII:1 (b) in the alternative.

In terms of the examined defensive measures we find it most feasible to impose Anti-Dumping duties.

[2] The same disclaimer as in the paragraph before applies. This advise is only intended to summarize the findings and to give a hint on the practical relevance of this memorandum.

III. INTRODUCTION

"We're in the midst of an international currency war."[3] So declared Guido Mantega, Brazil's finance minister as an example for a developing country, in a colorful phrase that captured the essence of central bank intervention across the industrialized world in the months previous to September 2010. A currency war, he elaborated, "threatens [Brazil] because it takes away our competitiveness"[4] by artificially forcing foreign goods to be cheaper in international markets. However, Brazil was far from the only government at the time fretting about currency manipulation as a barrier to trade.

At the same time that Mantega warned of a currency war, the United States House of Representatives prepared the arsenal of it. Specifically, the House debated and eventually passed a bill aimed at the People's Republic of China, and its currency, the Renminbi. The bill would have slapped countervailing duties against Chinese goods if the President determined that China had kept its exchange rate "fundamentally and actionably undervalued,"[5] on the basis that such undervaluation constituted an export subsidy.[6] Countervailing duties, a defensive measure under the WTO legal system, were suddenly being peddled by the world's biggest economy against the world's second-biggest economy as a viable solution to the exchange question. Yet the consistency of such duties and other WTO remedies with WTO requirements was far from settled, and remains unsettled to this day. And given the size of the players involved, settling the exchange rate question in the WTO is far from a light task.

This legal memorandum aims to illuminate some of the questions surrounding the WTO legality of exchange rate undervaluation. Namely, this memo explores a variety of WTO articles in-depth to determine where exchange undervaluation may be

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[3]Jonathan Wheatley. "Brazil in 'currency war' alert." Financial Times, September 27, 2010, sec. Americas / Finance & Markets. http://cachef.ft.com/cms/s/0/33ff9624-ca48-11df-a860-00144feab49a.html. (Accessed 4/4/2011).

[4] Jonathan Wheatley. "Brazil in 'currency war' alert." Financial Times, September 27, 2010, sec. Americas / Finance & Markets. http://cachef.ft.com/cms/s/0/33ff9624-ca48-11df-a860-00144feab49a.html. (Accessed 4/4/2011).

[5] "Brazilian Finance Minister Warns of 'International Currency War'." ICTSD Bridges Weekly Trade News Digest, September 29, 2010. http://ictsd.org/i/news/bridgesweekly/85803/. Accessed (4/4/2011).

[6] "Brazilian Finance Minister Warns of 'International Currency War'." ICTSD Bridges Weekly Trade News Digest, September 29, 2010. http://ictsd.org/i/news/bridgesweekly/85803/. Accessed (4/4/2011).

challenged as illegal, and also explores the possible defenses that an allegedly undervaluing country could use against such articles. To make this analysis, this memo takes a unique perspective that goes beyond the usual suspects of the United States and China; namely, this memo takes the perspective of a large developing country. While WTO remedies for China's exchange undervaluation have been often discussed from the perspective of the United States as a complainant, little work has been done from the perspective of complainants from other developing countries.

This memorandum can be divided into three parts. In the first part, some background information will be provided as to how, in economic terms, exchange undervaluation can constitute a barrier to trade, and how the original postwar political order designed the international economic legal system to address this issue. Then, with this background in mind for interpretive purposes, in the second part this memo will analyze various provisions of the WTO Agreement and assess them as possible avenues for litigation against China and its exchange regime. To do so, this memo will distinguish between "Offensive" and "Defensive" legal actions, and assess each for their viability. Finally, in the third part this memo will offer some general conclusions and recommendations about currency disputes, and from a strategic standpoint, suggest the best arguments countries should make to litigate or defend against such disputes in the future.

IV. BACKGROUND INFORMATION

Currency undervaluation is a particularly devious kind of trade barrier: one that is economically obvious, but legally murky. As will be shown, the original GATT rules only had a vague idea of the scale that currency undervaluation could distort trade, and these provisions in the GATT remain untested to this day. Nevertheless, until countries test these rules or preclude them with a political solution, it is likely that the undervaluation problem will continue apace.

A. CURRENCY UNDERVALUATION HAS THE ECONOMIC CONSEQUENCES OF A BARRIER TO TRADE

On the one hand, the economic consequences of currency undervaluation are remarkably similar to other kinds of trade barriers regulated under the WTO, especially subsidies and tariffs. Consider the mechanics of currency undervaluation. To intervene in the currency market, central banks must buy and sell foreign exchange to an extent large enough to move the market in a particular direction. In the case of undervaluation, this intervention means issuing enough of the domestic currency in the undervaluing country (or increasing that currency's supply) to buy up foreign currencies on world markets (or increasing those currencies' demand). Together, these supply and demand affects push the relative price of the domestic currency lower than it otherwise would be against foreign currencies. Since international trade requires converting one currency to another according to an exchange rate, after exchange all the goods denominated in the undervalued currency look "cheaper" to purchasers from abroad, and conversely, foreign goods look "more expensive" to purchasers at home. Hence, the undervaluing central bank encourages exports by reducing the price of domestic goods abroad (like a subsidy), and simultaneously, discourages imports by increasing the price of foreign goods at home (like a tariff).

We can see these subsidy and tariff effects today in the case of China's undervaluation against the U.S. dollar. Since 2001 China has run massive trade

surpluses, and through these surpluses, steadily acquired massive reserves of U.S. dollars in exchange. With these dollar reserves in hand, the Chinese government has invested them in U.S. Treasury Bonds, thereby propping up the value of the dollar versus the RMB. As a result, China has subsidized demand for Chinese exports to the U.S. Indeed, when Chinese exporters exchange their dollars acquired from abroad for RMB, those exporters receive extra RMB than they otherwise would at a market exchange rate. Simultaneously, when Chinese importers exchange their RMB for U.S. dollars, they receive fewer dollars than they would at a market exchange rate. Hence, China's currency manipulation thus exhibits both a subsidy and a tariff effect.

Less discussed, however, is how these effects also redound to third parties, such as Brazil. The Brazilian real for example, which, like the dollar, trades according to a free-floating market exchange rate, accordingly appreciates vis-à-vis the RMB whenever China intervenes to keep the RMB undervalued. As a result, Chinese undervaluation keeps Brazilian products, like American products, artificially expensive in China; simultaneously, it keeps Chinese products artificially cheap in Brazil, like it does in America. Chinese undervaluation has hurt the competitiveness of Brazilian industry, especially manufactured goods such as textiles, electronics, machinery and steel.[7] In short, China's undervaluation raises trade barriers to countries far beyond the target of its peg.

If America were to undervalue its own currency in retaliation to China's undervaluation the trade barrier would compound even further on Brazil. Not only would Brazil lose market access to America, in addition to China, but it would also compete against artificially cheap American imports, in addition to Chinese imports. Caught up in the currency war, Brazil would face pressure to undervalue as well, posing risks to still further third parties. As a result, competitive undervaluation constitutes not merely a bilateral risk to Brazil, but indeed, a multilateral risk to the entire trading system. Multilateral rules exist to address it.

[7] Fernando Ribeiro and Henry Pourchet, "O Pefil do Comércio Brasil – China", http://www.funcex.com.br/material/rbce/79-BC-FJRHP.pdf (Accessed 21/04/2011), p. 79.

B. ALTHOUGH NEITHER THE WTO NOR THE IMF HAVE RULED ON CURRENCY UNDERVALUATION, THE WTO IS THE MORE RELEVANT FORUM TO PURSUE SUCH A CLAIM

As a result of these subsidy and tariff affects, one might think that international economic law possesses clear legal disciplines for addressing currency manipulation. Indeed, both the trade regime of the WTO and the monetary regime of the IMF stand out as possible fora for the issue, each with their own obligations.

The reality, however, is less clear. While the WTO nominally possesses many provisions on this issue, case law has elaborated upon few if any of these provisions. Indeed, the currency provisions of the WTO lie largely dormant in the text, in force on paper but never put into practice. Further, at times these provisions seem to rely on the IMF to determine questions of undervaluation. Yet as will be shown in the substantive analysis of GATT Article XV later in this memo, the IMF provides no more light on these issues either. Despite over forty thousand requests to do so, the IMF has never found a country to violate its rules on currency undervaluation. Further, the IMF lacks a judicial institution like the WTO's dispute settlement body (DSB). Instead, it possesses only a political institution in the form of the executive board, whose members vote proportional to their country's financial share. These members are unlikely to adopt a ruling that threatens their monetary sovereignty. As a consequence, the IMF has provided little precedent on the issue thus far, and is unlikely to do so for the foreseeable future.

Faced with the problems of each forum, this memorandum ultimately analyzes currency undervaluation under the obligations of the WTO. As already outlined above, currency undervaluation significantly impacts trade flows today, similar to if not more than conventional subsidies and tariffs. Further, given the WTO's reverse-consensus rules on adopting DSB reports, the WTO seems more plausible than the IMF to ever find a violation in the first place. As a consequence, this memorandum will primarily analyze the currency undervaluation provisions of the WTO agreements, and only where necessary, those IMF rules to which the WTO makes reference. These textual analyses can be found in sections V and VI.

Nevertheless, before interpreting the legal text of these provisions, one must first understand them according to the historical context under which they arose. For

the GATT Agreement—and the old IMF articles to which it made reference—are artifacts of a bygone era in international trade; namely, the era of fixed exchange rates. Despite their historical quality, the era's legal obligations continue to this day.

C. THE GATT RULES ARE UNCLEAR ON CURRENCY UNDERVALUATION BECAUSE THEY WERE WRITTEN FOR AN INTERNATIONAL MONETARY REIME THAT HAS SINCE PASSED

The General Agreement on Tariffs and Trade, like all bodies of law, is a product of historical circumstance. As a consequence, its provisions are predicated on certain assumptions from its time, assumptions which may not always hold true in the present day. The currency undervaluation provisions of the GATT especially suffer from this disconnect between original assumption and modern practice. Indeed, this disconnect lies at the heart for why the currency undervaluation provisions enact such unclear obligations in the WTO system.

Before turning to this disconnect, it is important to examine the intent behind the formation of the GATT/WTO in the first place. Conceived in 1947, the GATT was formulated with the purpose to avoid the competitive tariff policies that had arisen during the Great Depression.[8] Indeed, the drafters included it as part of a trifecta of international organizations that would guide the international economic sphere for the postwar period. Earlier, at the Bretton Woods conference in 1944, the western Allied powers of World War II had already negotiated the other two organizations, the International Monetary Fund and the World Bank, to respectively handle monetary and postwar reconstruction issues.[9] As a consequence, the negotiators could take the rules of the IMF and World Bank for granted when they developed the rules for an organization to govern international trade.

And so they did. Although the GATT 1947's permanent international organization, or "International Trade Organization," never entered force at this time for want of U.S. ratification, the negotiating countries retained the GATT rules on a provisional basis for decades to follow. In the series of trade "rounds" that followed,

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[8] Andrew Guzman and Joost Pauwelyn, "International Trade Law" (2009), Aspen Publishers, 1st ed., p. 82.

[9] Peter van den Bossche, "The Law and Policy of the World Trade Organization: Text, Cases and Materials" (2005), Cambridge University Press, 1st ed., p. 79.

the countries slightly expanded these provisional rules to include some other aspects of international trade besides tariffs, such as dumping and development.[10] Nevertheless, the core distinctions remained between the three postwar economic institutions, and each largely stuck to its own domain. With the passage of the Uruguay Round in 1994, the GATT finally obtained its status as a permanent international organization, now named the World Trade Organization. Further, the 1994 Agreement wholly adopted the amended GATT 1947 text and added "teeth" to it in the form of a binding dispute settlement body.[11] Hence decades-old trade rules had been reaffirmed and made permanent for a new era.

Yet if the rules remained the same, the international political context for them had changed, especially with regard to currency conversion. In 1944, the Bretton Woods negotiators had agreed to fix the conversion of international currencies to the U.S. dollar, which in turn was convertible for gold at 35 USD per ounce. Like the GATT's intent to halt beggar-thy-neighbor trade policy, this exchange rate fixing was done with the intent of preventing competitive devaluations—or currency wars—of the 1930s.[12] The IMF would administer the system, tracking countries currency reserves to ensure none deviated from their "par value" against the U.S. dollar. If a country wanted to devalue its fixed exchange rate, it would first have to gain authorization from the IMF.[13] Thus, for a time, the IMF had effectively safeguarded one aspect of the world trading system, currency undervaluation, while the GATT safeguarded another aspect, tariffs. Reflecting this division of duties, the currency undervaluation Articles in the GATT 1947 repeatedly make reference to the articles of the IMF.[14]

However, a balance-of-payments decline in the United States brought this exchange rate system to its knees, and with it, the separation of monetary and trade policy. In 1971, U.S. President Nixon halted the convertibility of dollars into gold, and major economies responded in the ensuing five years by letting their currencies float against the dollar.[15] With the internationally agreed upon pegs no longer in

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[10] WTO Secretariat, "The GATT years: from Havana to Marrakesh." http://www.wto.org/English/thewto_e/whatis_e/tif_e/fact4_e.htm. (Accessed 22/4/2011).
[11] Ibid.
[12] Joseph Gold, "Legal and Institutional Aspects of the International Monetary System," (1984), International Monetary Fund, p. 81.
[13] Ibid.
[14] See for examples GATT Articles II:6 and XV. A legal discussion of these articles follows later in this memorandum.
[15] Barry Eichengreen, "Exorbitant Privilege: The Rise and Fall of the Dollar," (2011), p. 76-82.

force, the IMF ceased its function as the steward of the old exchange regime. As a consequence, the monetary assumptions on which the GATT 1947 had been based no longer exist. Prior to 1971, GATT tariff concessions were much stricter since they could not be offset by countervailing currency undervaluation (unless IMF approved). However, after 1971, countries could "give" with the one hand, by making tariff concessions, only to "take away" with the other, by devaluing their currencies. As a result, the 1971 change has left the rules on currency undervaluation with an unstable interpretive anchor. Given that the IMF no longer fixed par values according to the exchange rates of Bretton Woods, how can the GATT rules still use IMF par values as a benchmark for undervaluation?

The question is an important one, because it throws light on a gaping hole in the world trading system today. While countries today could still ask the IMF to determine whether a member undervalues its currency, this result seems implausible because of the political structure of the IMF, discussed earlier. Further, although negotiators have updated many GATT rules to reflect changing times, from the scope of intellectual property rights to antidumping rules, the rules on currency undervaluation have received no such update. From a political standpoint, negotiators should feel pressed to update them, for they are one of the greatest tools of trade control in the world today. While the IMF does have post-1971 rules against currency manipulation, as will be discussed in the GATT Article XV legal analysis, trade negotiators would add certainty to the system if they referenced these new rules in the GATT Agreement, rather than the implicit assumptions of 1944.

In the absence of an update by the WTO members, however, the old rules remain in force. And with this historical context in mind, this memorandum will now examine these rules for their applicability in today's context. Even if they could be much improved, the GATT rules still provide some remedies presently to counter currency undervaluation as a barrier to trade.

V. OFFENSIVE LEGAL ACTION

A. AN UNDERVALUED RMB UNDERMINES CHINA'S TARRIF CONCESSIONS, BUT PROBABLY DOES NOT VIOLATE GATT ARTICLE II

1. Overview

The RMB's undervaluation by the People's Bank of China might cause a breach of GATT Article II. Specifically, the RMB's undervaluation may cause China to effectively breach its tariff bindings, resulting in a *de facto* violation of GATT Article II:1 (a) and/or (b). Additionally, the RMB's undervaluation may "impair the value" of China's concessions, resulting in a violation of GATT Article II.3. This section will begin with a discussion of potential Article II:1 (a) and (b) violations, then discuss a potential GATT Article II.3 violation.

2. GATT Article II:1 (a) and (b)

To determine any GATT Article II violation, one must compare three documents: the GATT Article II legal text, the respondent member's Schedule of Concessions, and the respondent member's applied tariff rates as posted by the member government. The analysis here begins with the legal text. GATT Article II prohibits the application of tariff rates above the bound rates in a member's schedule. Specifically, this requirement arises in GATT Article II:1 (a) and (b), first sentence. Paragraph (a) requires countries to accord "treatment no less favourable" than that in the schedule, while paragraph (b) exempts countries from ordinary customs duties in excess of those provided in the annexed member schedules.

The Appellate Body elaborated on the relationship between these paragraphs in the case *Argentina – Textiles*. In that case, specifically, the AB stated that paragraph (a) "contains a general prohibition against less favourable treatment" than the treatment provided in the schedule, while paragraph (b) "prohibits a specific kind of practice that will always be inconsistent with paragraph (a): that is, the application

of ordinary customs duties in excess of those provided for in the Schedule."[16] Hence, under the AB's logic, a violation of GATT Article II:1 (b) is sufficient but *not necessary* to find a violation of GATT Article II:1 (a).

a) *Currency undervaluation is not a de jure violation of GATT Article II:1 (b), first sentence*

On the question of whether an undervalued RMB violates II:1 (b), first sentence, by forcing one or more of China's applied tariff rates above its bound rate, one must draw a distinction between a *de jure* and *de facto* violation of II:1 (b). To find a *de jure* violation of II:1 (b), first sentence, China would have to be committed to a specific currency regime in its Schedule of Concession, which it is not. Hence the *de jure* test fails.[17]

b) *Currency undervaluation may de facto violate GATT Article II:1 (b), 1st sentence*

Nevertheless, a *de facto* violation II:1 (b), first sentence, may exist. Although currency undervaluation does not require the customs of authorities of China to levy payments on Chinese imports, undervaluation implicitly still brings about this effect.[18] That is, the undervaluation of the RMB reduces the RMB's purchasing power of goods from abroad by the degree undervalued, and hence implicitly duties foreign goods. If the degree of undervaluation were counted as a "duty" on top of the applied rates of China's customs agency, some of China's tariffs would breach their bound rates in the Schedule of Concessions.

For example, take it as given that China has undervalued its currency by 25%, meaning that imports are essentially 25% more costly (or as if a 25% duty has been

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[16] WTO, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, Appellate Body Report (April 22, 1998), WT/DS56/AB/R para. 45.

[17] China's schedule and accession was concluded in November 2001 and can be officially found with the WTO Secretariat. "Protocols of accession for new members since 1995, including commitments in goods and services," available on the WTO website at http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm. Accessed 2/4/2011.

[18] Aaditya Mattoo and Arvind Subramanian, "Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization", Policy Research Working Paper no. 4668, The World Bank Development Research Group Trade Team, (2008), p. 3.

added to them). Since all of China's duties are *ad valorem*, this 25% undervaluation essentially means that all of China's concession lines with bound rates of less than 25% would violate GATT Article II:1 (b) first sentence. Snow ploughs and snow blowers (HS 84302000), for instance, have a bound rate of 10%; as a result, a 25% currency undervaluation would mean that the applied rate on this tariff line would be *at least* 15% over its binding, even when China's customs authorities applied a zero tariff rate on paper.

Still, much of this *de facto* argument hinges on to what degree undervaluation can be construed as a "duty," which is a limiting categorical term. The danger here lies in the fact that if currency undervaluation were included as a form of *de facto* tariff, just by dint of raising the price of imports, any economic policy that raised these prices would qualify as a tariff. Instead, it may be easier for undervaluation to violate GATT Article II by merely turning straight to paragraph (a), with its general prohibition against providing less favourable treatment.

c) Currency undervaluation may violate GATT Article II:1 (a)

The logic of *Argentina – Textiles* leaves open the possibility that GATT Article II:1 (a) may be violated independently of a violation of any other GATT II:1 Articles. To find a violation in paragraph (a), China's undervaluation would have to accord to commerce of the other contracting parties treatment "less favourable" than that provided in China's Schedule. Since (a) is a general obligation against less favourable treatment while (b), first sentence, requires "duties" "in excess of" the Schedule, the scope for violation in (a) is considerably broader than the scope in (b). As the AB mentioned in A*rgentina – Textiles*, paragraph (b) is merely one example in the larger category of less favourable treatment.[19] Hence, paragraph (a) can arguably oblige members to provide "treatment no less favourable" to policies beyond tariffs, which leaves room for currency manipulation.

The meaning of the phrase "treatment no less favourable" in the context of GATT Article II:1 (a) has been defined only once, in the recent panel report of *EC –*

[19] WTO, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, Appellate Body Report (April 22, 1998), WT/DS56/AB/R para. 45.

IT Products.[20] In that case, the panel drew attention to meaning of "less favourably" previously defined by the Appellate Body in *Korea – Various Measures on Beef*, a GATT Article III.4 case. The Appellate Body in *Korea – Beef* determined less favourable treatment by examining whether a measure modified the "conditions of competition"[21] between a domestic and imported like product. In *EC – IT Products*, the panel adapted this reasoning to a member's Schedule of Concessions, and considered "negotiated tariff concessions" and "the certainty [of those concessions]" to be "market access guarantees," which are in turn a kind of competitive condition.[22] On this basis, the panel devised a specific test for the violation of II:1 (a):

> "if a measure adversely affects the conditions of competition for a product from that which it is entitled to enjoy under a Schedule, this would be less favourable treatment under Article II:1 (a)."[23]

Hence, so long as China's currency undervaluation "adversely affects" the "conditions of competition" promised for a given product tariff commitment in China's Schedule, the undervaluation can violate GATT Article II:1 (a), without reliance on GATT Article II:1 (b). This language in *EC – IT Products* is broad, obliging not only tariff measures, but any measure that would adversely affect conditions of competition enjoyed in a Schedule. Thus, although the measure at issue in *EC – IT Products* was a narrow tariff measure,[24] the panel's logic can be applied to other measures that adversely affect the tariff concessions in a member's schedule.

China's currency undervaluation seems to fulfill this test. Since China's currency undervaluation limits the purchasing power of the RMB against foreign currencies, and hence raises the real price of foreign goods, the undervaluation adversely affects the Schedule's guarantees for market access at the bounded tariff rates. Since market access is a kind of competitive condition included by the panel,

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[20] WTO, European Communities and its Member States – Tariff Treatment of Certain Information Technology Products*,* Panel Report (August 16, 2010), WT/DS375/R, WT/DS376/R, WT/DS377/R, paras. 7.755 to 7.757.

[21] WTO, Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, Appellate Body Report (December 11, 2000), WT/DS161/AB/R. para. 137.

[22] WTO, European Communities and its Member States – Tariff Treatment of Certain Information Technology Products*,* Panel Report (August 15, 2010), WT/DS375/R, WT/DS376/R, WT/DS377, para. 7.757.

[23] WTO, *European Communities and its Member States – Tariff Treatment of Certain Information Technology Products,* Panel Report (August 15, 2000), WT/DS377/R, para. 7.757.

[24] Specifically, tariff suspensions for certain classes of IT products.

and currency undervaluation adversely affects this competitive condition, then undervaluation results in less favourable treatment as prohibited in GATT Article II:1 (a). Essentially, currency undervaluation renders meaningless the market access guarantees of GATT Article II:1 (a), and hence the undervaluation accords less favourable treatment to the commerce of contracting parties expecting such guarantees.

The panel's interpretive focus in *EC – IT Products* on competitive conditions, and guarantees of market access, seems to be strengthened in the case of currency undervaluation by the requirements of GATT Article II.3. Although the *EC – IT Products* case dealt with a kind of tariff measure, namely duty exemption, the panel's emphasis on "conditions of competition" could be extended GATT Article II.3, which addresses currency conversion. This GATT article explicitly prohibits a member from altering the method of converting currencies to impair the value of the concessions in the Schedule (see below where it is quoted in full). To the extent that currency undervaluation results in less favourable treatment than that provided in the Schedule, and this less favourable treatment impairs the value of the Schedule's concessions, these two articles might be read together.

In addition, currency undervaluation could independently violate GATT Article II.3. This Article II.3 claim can be argued as either a compliment or as an alternative to the no less favourable treatment obligation Article II:1 (a); both are viable strategies. A measure in violation of Article II.3 would necessarily result in less favourable treatment.

3. GATT Article II:3

GATT Article II.3 prohibits members from altering their method of converting currencies so as to impair the value of concessions in the Schedule. As a result, the scope of GATT Article II goes beyond tariffs. The text reads thus:

> 3. No contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the concessions provided for in the appropriate Schedule annexed to this Agreement.

This article contains two prohibitions; the first, against altering the method of "determining dutiable value," is given more specific focus GATT Article VII and the 1994 Agreement on Implementation of GATT Article VII, otherwise known as the Customs Valuation Agreement. It is not the focus of the discussion here, although the Customs Valuation Agreement will arise later in this memorandum. The second prohibition, against altering the "method of…converting currencies" so as to "impair the value" of concessions, will be discussed here.

Two phrases stand out in this prohibition, which will require definition: namely, the definition of a "method of converting currencies," and what it means to "impair the value" of concessions.

a) "method of…converting currencies."

No case law exists for GATT Article II.3 at this time, making this Article more difficult to interpret than GATT Articles II:1 (a) and (b). To constitute a violation of II.3, China's currency undervaluation would have to fall under the definition of an altered "method of converting currency." According to the Oxford English Dictionary, the ordinary meaning of the word "method" is as follows: "a particular procedure for accomplishing or approaching something, especially a systematic or established one."[25] So, to the extent that currency undervaluation alters the systematic procedure for converting currency, such undervaluation can be considered to alter the "method" of converting currency.

On the one hand, a *prima facie* case can be made that currency undervaluation alters the method of converting currency. Since the method of converting a currency merely entails multiplying the home currency by its exchange rate with the foreign currency, an undervalued home currency would have the effect of suppressing the proper multiplier. Hence, this suppression would constitute "altering" the method of converting currencies.

On the other hand, if one determines a "method" of converting currencies by looking to the exchange rate expectations in a member's Accession, then undervaluation in China's case may not result in altering the method of currency conversion. One aspect of the ordinary meaning of "method" is the word's quality of

[25] Oxford Dictionaries Online, http://oxforddictionaries.com/. Accessed 4/4/2011.

"systematic procedure." A systematic procedure—in the sense of having a predictable application—usually develops over past practice, and entails expectations for future practice. In this regard, to determine past practice and expectations for the future in the context of China's currency conversion, China's Accession Protocol Working Party Report sheds some light. This Working Party Report stated:

> "China had adopted a single and managed floating exchange rate regime based on supply and demand. PBC published the reference rates of RMB against the US dollar…. The buying and selling rates of RMB against the US dollar on the inter-bank forex market could fluctuate within 0.3 per cent of the reference rate….. The exchange rates for other foreign currencies [besides the US dollar, HK dollar and Japanese yen] were based on the rates of RMB against the US dollar and cross-exchange rates of other foreign currency on the international market. The permitted margin between the buying and selling rate could not exceed 0.5 per cent."[26]

Arguably, in this paragraph the Working Party Report established the expected method of converting RMB to the dollar—namely, by using a managed peg with no more than 0.3 percent market appreciation allowed on the reference rate. To the extent that undervaluation is expected of a "managed floating exchange rate regime" with such a low appreciation cap, undervaluation might be understood as consistent with China's method of converting currency.

In response to this argument, the other side might claim that even if the Working Party Report establishes the method of converting currencies, the RMB's undervaluation falls under the reference rate, not the space for appreciation. Hence, if the RMB were appropriately valued based on "supply and demand," as the Working Party Report claims, then the reference rate would be much higher in the first place. Consequently, since the RMB to US dollar conversion does not use a reference rate based on supply and demand, but rather uses a much undervalued reference rate, this undervaluation alters the RMB's method of converting currency.

Overall, the equivocal wording of the Working Group Report renders it difficult to determine what the normal, un-"altered" method of converting currency

[26] WTO, Report of the Working Party on the Accession of China to the WTO (November 10, 2001), WT/MIN(01)/3. Paragraph 31.

would be in the case of China, and hence whether undervaluation alters China's "method of…converting currencies." Conceivably a continuum exists between exchange rates based entirely on supply and demand, on the one hand (aka "floating" exchange rates), and exchange rates entirely immune from supply and demand, on the other (aka "pegged" exchange rates). The Working Party Report strikes a balance between these two extremes, closer to the side of a peg than to market forces, given the tiny margins allowed for market fluctuation. So, for the RMB's undervaluation to "alter" the method of currency conversion, the scale of the RMB's undervaluation would probably have to exceed the already permissible standard in the Working Party Report. Since the Working Party Report seems to *describe* its general "managed floating exchange rate" commitment as a RMB-to-dollar peg at "0.3" percent, China's currency undervaluation is probably consistent with this commitment.

Further, there is a second requirement for a violation of GATT Article II.3. The alteration of the method of converting currency must be of a degree large enough "so as to impair the value of any of the concessions."

b) Alteration of the method of converting currencies

Presuming for the sake of argument that currency undervaluation fits the definition of "altering" the method of currency conversion, such currency undervaluation would still have to "impair the value" of the concessions in China's schedule to violate GATT Article II.3. On this point, GATT Article XXIII on "nullification and *impairment*" provides a specific legal test of "impairment," and thus should probably be used to determine the meaning of "impair" in GATT Article II.3. Indeed, GATT Article XXIII:1 governs the procedures for determining nullification or impairment for the whole GATT Agreement;[27] hence, GATT Article II.3 would fall under it.

A more detailed analysis on whether China's currency undervaluation consists of nullification or impairment can be found on page 36. There, this memorandum concludes that China's currency undervaluation probably impairs the tariff concessions granted by China to other WTO members by imposing on foreign

[27] See GATT Article XXIII.1. "If any contracting party should consider that *any benefit* accruing to it directly or indirectly under *this Agreement* is being nullified or *impaired*..." (emphasis added).

products an "exchange extra" surcharge that runs counter to Member's legitimate expectations.

4. GATT Article II:6

A member has a right under GATT Article II.6(a) to raise its bound specific duties if the par value of its exchange rate is reduced by more than twenty percentum, and this par value reduction is confirmed by the International Monetary Fund and the other contracting parties. The rule, never interpreted in case law, reads as follows:

> "6. (a) The specific duties and charges included in the Schedules relating to contracting parties members of the International Monetary Fund, and margins of preference in specific duties and charges maintained by such contracting parties, are expressed in the appropriate currency at the par value accepted or provisionally recognized by the Fund at the date of this Agreement. Accordingly, in case this par value is reduced consistently with the Articles of Agreement of the International Monetary Fund by more than twenty per centum, such specific duties and charges and margins of preference may be adjusted to take account of such reduction; provided that the CONTRACTING PARTIES (i.e., the contracting parties acting jointly as provided for in Article XXV) concur that such adjustments will not impair the value of the concessions provided for in the appropriate Schedule or elsewhere in this Agreement, due account being taken of all factors which may influence the need for, or urgency of, such adjustments."

In the case of the RMB's currency undervaluation vis-à-vis to - for instance the Brazilian real - , this article's right is not of very much relevance, because all of Brazil's duties in this case are bound and applied on an *ad valorem* basis.[28] *Ad valorem* duties do not need to be adjusted with currency movements since their value is expressed as a percentage, and consequently are not tied to the swings of a currency's value. As a result, Brazil's duties for example would not qualify for this GATT Article II:6 right—and neither, incidentally, do most countries' duties since the

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[28] "Tariffs – Get Tariff Data," available on the WTO website at http://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm. Accessed 4/4/2011.

vast majority of bound rates are done an *ad valorem* basis, including China's. (Still, there are notable exceptions, such as Iceland, Switzerland, and Norway in the area of agricultural products.)[29]

Further, it should be noted that this article only grants the right of upward adjustment when a country's currency loses value. If for example Brazil had a specific duty on Grammophone records at ten real per record, and the value of the real fell by half—so that China's market access in Brazil doubled concordantly—then Brazil could adjust its specific duty upward to reflect this devaluation.[30] Hence, this article protects members from over-conceding market access as a result of unintentional undervaluation. However, the article does not address the opposite situation—namely, when members *under*-concede market access as a result of undervaluation, as is the case of China. As discussed in the "Background" section of this memorandum, when China undervalues its currency, it reduces the purchasing power of its consumers to buy Brazilian goods. Further, since China has no specific duties, there is no countervailing market opening from undervaluation to balance its reduced purchasing power. As a consequence, Article II:6 is inapplicable.

Nevertheless, it is important for interpretive purposes to draw attention to the *par value threshold* that Article II:6 (a) requires to trigger this right to adjust a member's specific duties. Namely, "twenty *percentum*." If a reduction in a member currency's par value by 20% is sufficient to warrant adjusting that member's specific duties, and so presumably preserve the real value of that member's level of concessions, then this 20% threshold may be a useful standard to apply to questions more generally of at what point currency undervaluation impairs concessions. After all, in a world monetary system primarily composed of floating exchange rates, some temporary and marginal undervaluation/overvaluation should be expected. No other *quantitative* standard of currency undervaluation exists in the WTO Agreement. Since this memorandum takes for a given on the basis of outside economic analysis that the RMB is undervalued by 25%, the RMB in this case would surpass the 20% threshold allowed in GATT Article II:6(a). Further, like Article II:3, Article II:6 demonstrates

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[29] Sohini Chowdhury, "The Discriminatory Nature of Specific Tariffs," (2009), p. 23. https://www.gtap.agecon.purdue.edu/about/documents/seminars/Chowdhury_ID58.pdf (Accessed 25/5/2011).

[30] For more detail, see for example Greece's 1953 request to adjust its bound rates in accordance with GATT Article II:6. GREEK SCHEDULE XXV - ADJUSTMENT OF SPECIFIC DUTIES: Note by the Secretariat. W.8/31 20 October 1953, http://www.wto.org/gatt_docs/English/SULPDF/91850366.pdf.

that Article II has a scope that goes beyond the nominal tariff bound and applied rates and includes questions of currency valuation.

5. Conclusion

For the RMB's undervaluation to violate GATT Article II, it will most likely arise out of a de facto violation of the concessions bound in China's Schedule, and in defiance of the expectations laid out in China's Accession Protocol. The strongest of these violations lies in GATT Article II.3's prohibition against altering "the method of…converting currencies" to impair the value of concessions, including the bound tariff rates mentioned in GATT Article II:1 (b), which means that China is not allowed to undervalue its currency to de facto exceed its bound tariff rates. To determine whether the RMB's devaluation is of a great enough scale to "impair the value" of concessions, II.6(a) is suggestive that a 20% undervaluation is sufficient; the RMB is undervalued even further than this threshold. Finally, all of these violations possibly constitute "less favourable treatment" under GATT Article II:1 (a), and even if they do not, the RMB's undervaluation possibly accords "less favourable treatment" independent of these violations, because it reduces the value of the annexed tariff concessions. Nevertheless, an Appellate Body or panel has yet to rule on these exchange issues, and given the uncertainty of the case, defensive measures instead might make for a more immediately effective way for a developing country to remedy China's currency undervaluation.

B. A CLAIM UNDER GATT ARTICLE XV COULD BE ATTEMPTED, INASMUCH AS THE INTENT OF ANOTHER SPECIFIC GATT OBLIGATION IS BREACHED

1. Overview

GATT Article XV was drafted to facilitate the coordination between the IMF Articles and GATT on certain issues of monetary policy for which the Fund was specifically created, such as balance of payment and exchange measures.[31]

For the purpose of this memorandum, we shall consider the possibility of a claim of currency undervaluation being made under Article XV:4 which is the GATT provision that directly links exchange rate policy to WTO legality. However, due to the interconnected nature of the paragraphs of GATTT Article XV, a previous overview of the norms contained in Article XV:2 and Article XV:9 is required so as to be possible to thoroughly analyze paragraph 4.

For this reason, we shall dedicate some of the following paragraphs to the discussion of GATT Article XV:2, which establishes the relationship between WTO members and the IMF on matters of monetary reserves, balances of payment and foreign exchange arrangements, while setting out the principle of WTO consultations with the Fund and the scope of those consultations. We shall also introduce a summarized description of the legal coordination between the WTO and the IMF.

We shall then analyze Article XV:9 which provides a carve-out to exchange rates under GATT. The importance of this provision lies in its potential to override Article XV:4. [32]

Finally, considering the analysis developed below, we conclude that there is indeed a possibility for discussion of a claim against the Chinese exchange rate policy on the basis of Article XV:4. However, certain criteria would have to be met, none of which have so far been analyzed by a WTO Panel. That makes the outcome of such a dispute difficult to foresee.

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[31]Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 608.

[32] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 12.

2. Article XV:2

Article XV:2 establishes an obligation of consulting the IMF on matters pursuant to provisions of its Articles of Agreement.

It states that a Panel needs to consult formally with the IMF, if it has to consider issues concerning "monetary reserves", "balance of payments" and "foreign exchange arrangements"[33]. The fund's response thereto will be considered as fact, however, as discussed below whether or not such findings must be accepted is still a controversial matter.

GATT Article XV:2 reads:

> "2. In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or <u>foreign exchange arrangements</u>, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES <u>shall accept all findings</u> of statistical and other facts <u>presented by the Fund</u> relating to <u>foreign exchange, monetary reserves and balances of payments</u>, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in <u>accordance with the Articles of Agreement of the International Monetary Fund</u>, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES. (*emphasis added*)"[34]

In order to apply Article XV:4 to matters of exchange rate devaluation, as will be discussed in further detail below, it is important to determine the obligatory character of the requirement to consult with the IMF in such matters.

In this sense, the 1996 decision by the WTO General Council concerning agreements between the WTO, the IMF and the World Bank, established that Panels *are allowed to, but not obliged* to consult the IMF under Article XV:2, in view of

[33] Deborah E. Siegel "Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements" (2002), "The American Journal of International Law", Vol. 96, 2002, p. 572.

DSU Article 13, which states that “each Panel shall have the right to seek information and technical advice from any individual body it deems appropriate”.[35]

Also, the Appellate Body in “India Balance of Payments” considered, in reference to DSU Article 13, that a Panel, is not obliged to strictly implement IMF findings under Article XV:2, but rather to “critically access” the data provided, as if confronted with a simple *amicus curiae* brief.[36]

In Dominican Republic – Import and Sales of Cigarettes, the Panel considered that it needed to consult with the IMF based on paragraph 2 of Article XV on the matter of whether a foreign exchange measure constituted an "exchange restriction” in accordance with the IMF Articles and hence justified under Article XV:9(a) of the GATT 1994.”[37] The Panel, however, did not go as far as to consider whether it was *obliged* to consult with the IMF, leaving the impression it did so under the discretionary authority of DSU Article 13.[38]

Thus, as noted by Zimmermann (2010), the existing jurisprudence does not clarify as to whether the need of IMF consultation in Article XV:2 extends to dispute settlements. Nonetheless, we proceed under the assumption that if a case on currency manipulation were to be brought to the WTO dispute settlement system, the Panel would be obliged to consult the IMF on the basis of this provision.[39]

3. IMF Articles of Agreement

For its part, IMF law governs unilateral exchange rate intervention under IMF Article IV:1 (iii). It states that “each member shall… avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustments or to gain an unfair competitive advantage over the other members”.

[35] Claus D. Zimmermann, “Currency Manipulation and the Paralysis of the Law”, (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 32.
[36] WTO, India - Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products, Report of the Appellate Body (August 23, 1999), WT/DS90/AB/R 23, paras. 149 – 150.
[37] WTO, Dominican Republic - Measures Affecting The Importation And Internal Sale Of Cigarettes, Panel Report (November 25, 2004), WT/DS302/R, 26, para. 7.139.
[38] Claus D. Zimmermann, “Currency Manipulation and the Paralysis of the Law”, (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 35.
[39] Claus D. Zimmermann, “Currency Manipulation and the Paralysis of the Law”, (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), pp. 35-36.

It sets forth two standards that must be met to characterize a violation: "manipulation" of exchange rates and the "gain [of an] unfair competitive advantage". "Manipulation" has been defined by the June 2007 IMF Executive Board decision as "policies that are targeted at – and actually affect the level of an exchange rate" for the purpose of (i) "securing fundamental exchange rate misalignment"; and (ii) "securing such misalignments… to increase net exports."[40] Thus, as shown by Staiger and Sykes (2010), "before an IMF member may be found of having engaged in illegal currency manipulation, it must have deliberately affected the exchange rate to a degree sufficient to cause 'fundamental misalignment', and must have done so for the 'purpose' of increasing net exports."[41] Therefore, even if the IMF is to consider, as it has,[42] that the Chinese currency is valuated below its equilibrium, it would not amount to a breach of the IMF Articles, since the abovementioned criteria are not called into question.

It must also be noted that the oversight of members' compliance with IMF Article IV is attributed to the Fund itself by force of IMF Article IV(1) and (3). This is done through the mechanism of 'bilateral surveillance'[43] in which countries' policies are analyzed and consultations held by initiative of IMF staff with the aim of emphasizing "dialogue and persuasion".[44] This mechanism has proven so ineffective in terms of enforcement that, to date, IMF Article IV has been the cause to anywhere between forty to fifty *thousand* consultations, yet the IMF Executive Board has failed to find any violations in that regard.[45] Therefore, as will be discussed further below, the effectiveness of a WTO claim on monetary devaluation, requires that the scope of such an action avoids IMF surveillance altogether.

[40] International Monetary Fund (2007), Review of the 1977 Decision — Proposal for a New Decision, Companion Paper, Supplement, and Public Information Notice June 21, 2007, pp. 18 and 19
[41] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 591.
[42] "The currency of China still appears substantially weaker than warranted by medium-term Fundamentals" - IMF, "World Economic Outlook, April 2011", http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/text.pdf (Accessed 09/06/2011), p. 25.
[43] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 592.
[44] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 592.
[45] Michael Mussa "IMF Survailance over China's Exchange Rate Policy", Peterson Institute for International Economics, (2007), http://www.iie.com/publications/papers/mussa1007.pdf (Accessed 18/04/2011), p. 40.

4. Article XV:9

> "9. Nothing in this Agreement shall preclude: (a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party's special exchange agreement with the CONTRACTING PARTIES…"

Paragraph 9 provides a carve-out from Article XV when an exchange restriction is consistent with the IMF Articles of Agreement.[46] It prescribes that exchange controls or exchange restrictions in accordance with IMF law cannot be in breach of GATT.[47]

Further, IMF Article VIII:2 (a) prohibits members from imposing restrictions on payments and transfers for international transactions without approval from the IMF. Thus, unless a restriction is approved under Article VIII:2 (a), it would not fall under the exception of GATT Article XV:9.[48]

Koops (2008) points out that no explicit reference is made to exchange rates, but to "exchange controls" and "exchange restrictions". This way, Article XV:9 could be "meant to address the controls and restrictions themselves and not their influence on exchange rate."[49]

The IMF defines "exchange restrictions" on the basis of a test established by a 1960 ministerial decision that considers "whether [an exchange restriction] involves a direct governmental limitation on the availability or use of exchange as such".[50] It can be inferred that "exchange controls" and "exchange restrictions" both indicate the same governmental limitation, only with a variation of degree – a restriction being a more accentuated form of control." In the present matter, since the Chinese pegging

[46] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 11.
[47] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 38.
[48] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 39.
[49] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 11.
[50] Emphasis added, IMF decisions No. 1034-(60/27) (June 1960, updated June 2006) Apud Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 39.

policy consists of the assumption of an active role by the Central Bank in acquiring foreign debt to mitigate currency value[51] rather than a direct governmental limitation on the availability or use of exchange, this measure does not meet the definition of "exchange controls" adopted by the IMF itself.

5. Article XV:4

GATT's main obligation regarding exchange rate manipulation is laid down in Article XV:4.[52] It provides that members "shall not, by exchange action, frustrate the intent of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund". In order to establish the justiciability of a claim on monetary misalignment based on this provision, we shall analyze its two essential elements, namely "exchange action" and "frustrate the intent".

a) "Exchange Action"

It is noted that "exchange action", interpreted under its ordinary meaning, pursuant to Articles 31 and 32 of the VCLT, means "acts relating to the exchange rate", which would be equivalent to "exchange rate-based measures".[53]

In this sense, any exchange rate based measures would be "exchange actions" under Article XV:4. This would be a broad, "umbrella definition" which encompasses, not only the more specialized categories provided under Article XV:9 and Article XV:2 (respectively, "exchange controls" and "exchange restrictions"; and "foreign exchange arrangements", "foreign exchange " and "exchange matters"), but also "exchange rate policy", "exchange rate controls", "multiple exchange rates" and

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[51] IMF decisions No. 1034-(60/27) (June 1960, updated June 2006) Apud Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 39.

[52] Christoph Hermann, EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 2010 (2010), "Don Yuan: China's 'Selfish' Exchange Rate Policy and International Economic Law," http://www.springer.com/cda/content/document/cda_downloaddocument/9783540788829-c1.pdf?SGWID=0-0-45-835315-p173815045 (Accessed 10/03/2011), p. 46.

[53] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 119.

"multiple exchange rates made operational though taxes or fees", as provided in the preparatory works of Article XV.[54]

However, as explained above those categories provided by Article XV:2 and Article XV:9 will require their legality to be judged by the IMF on the basis of the respective IMF Article. For the reasons discussed above, such an irregularity is unlikely to be found.

In this sense, as shown by Koops (2008), "exchange actions" could violate Article XV:4, as long as they do not constitute "exchange controls" or "exchange restrictions" consistent with the IMF Articles.

Moreover, as pointed out by Miranda (2010) Article XV:2, first sentence, provides the obligation for consultation with the IMF only in cases concerning (i) monetary reserves; (ii) balances of payment; and (iii) *exchange arrangements*. Its second sentence determines that the WTO has to (i) *accept all facts* found by the Fund with relation to foreign exchange, monetary reserves and balances of payment; and (ii) *accept the determination of the Fund* as to whether an *action in exchange matters* is in accordance with the IMF Articles. Thus, the WTO would only be obliged to accept findings by the IMF in cases concerning "exchange arrangements". "Exchange actions" that violate GATT Article XV:4 would fall under the exclusive appreciation of a WTO Panel.[55]

This way, Article XV:4 may act as independent basis for a claim on exchange rate manipulation inasmuch as it refers to "exchange rate policy" or "exchange rate management"[56], which are "exchange actions", yet fall outside of the scope of paragraphs 2 and 9 of Article VX. This way, it could be argued that the Chinese policy of pegging the RMB below its undistorted value consists of an exchange rate policy that violates GATT Article XV:4 by frustrating the intent of another GATT provision.

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[54] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 119.

[55] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 120.

[56] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 121.

However, as Zimmermann (2010) points out, "in the absence of a single Panel decision on the matter, the issue remains somewhat speculative."[57]

b) "Frustrate the Intent"

The second element that needs to be considered in order to establish a violation of GATT Article XV:4 is whether an exchange action "frustrates the intent of this Agreement." The Ad Note to Article XV:4 provides some clarification as to what is meant by "to frustrate the intent" of GATT:

> "The word "frustrate" is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import license the country from which the goods may be imported, for t he purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls." *(Emphasis added)*

Although both examples provided by this *Ad Note* presume action in line with the IMF articles, they are of limited usefulness.[58] They do not relate to the issue of currency devaluation at hand, which, as discussed above, falls outside of the scope of analysis of the fund and thus should not affect the findings of a claim concerning "exchange actions" within the meaning of GATT Article XV:4.

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[57] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 42.

[58] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 122.

The *Ad Note* establishes, or at least gives examples where, a *de jure* violation of the letter of a specific GATT Article ("the letter of any article of this agreement") is not sufficient to "frustrate the intent" in the sense of Article XV:4 unless a "departure from the intent" of that specific GATT article can also be found. It follows that not all violations of GATT provisions would amount the "frustration of the intent" within the meaning of Article XV:4.

This way, as supported by Koops (2008) and Miranda (2010), the standard would be sufficiently met if only an exchange action was found to frustrate the intent of an individual GATT provision and not necessarily of the Agreement as a whole.[59] The Oxford English Dictionary describes frustration as the "prevention of success or fulfillment" of something[60]. Thus, an *ipso-facto* violation of a norm is not required by GATT Article XV:4, but only that its objective be debased.

This way, in order to establish that the Chinese policy of exchange rate devaluation constitutes a violation of GATT Article XV, it is necessary to determine which GATT provision has its intent frustrated by such an action.

As we will demonstrate in greater detail in pages 14 to 24 of this memorandum, we find that China's currency undervaluation may breach *de facto* or *de jure* its tariff commitments, under GATT Article II. Whether or not GATT Article II is found to be violated, a frustration of its intent which will breach GATT Article XV:4 may be inferred.

Moreover, we also consider that in the unlikely event that a panel, in analyzing whether the China's devaluation policy could be considered an actionable subsidy under the Subsidies and Countervailing Measures Agreement, finds that the element of "financial contribution" is met (as discussed in further detail in pages 44 to 48), the measure could be considered as a *de facto* subsidy. This way, even if there is no *de jure* violation of the norms contained within GATT Article VI with regards to

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[59] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 10; and Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 122.

[60] Oxford Dictionaries, "Frustration", http://www.oxforddictionaries.com/view/entry/m_en_gb0319450#m_en_gb0319450 (accessed 18/04/2011).

countervailing duties, such a finding might be enough to establish a violation of its intent which would equate to a breach of Article XV:4.

6. Conclusion

Article XV:4, in particular, precludes members from engaging in exchange actions that would frustrate the intent of GATT (understood as the intent of any individual provision therein). Although nothing in the treaty provides clear guidance as to exactly which measures would be contemplated by this provision,[61] or in what way such measures could affect the intent of specific GATT articles, paragraph 4 certainly stipulates the rule that, under the current incarnation of the General Agreement, most directly relates to the issue of currency devaluation.

A claim of violation of Article XV:4 should assert this provision's independent standing independently vis-à-vis paragraphs 2 and 9. Moreover, it will have to demonstrate the frustration of the intent of another GATT provision by an "exchange action".

For the purpose of a possible claim against China's currency devaluation, the claimant might choose to argue that the country's policy of mass-acquisition of foreign debt so as to meet a predetermined currency peg constitutes in itself an "exchange rate policy" which, in the sense given by Miranda (2010), falls under the scope of "exchange action"[62].

Finally, a WTO member will have to demonstrate that the Chinese exchange rate policy "frustrates the intent" of one or more GATT provisions. As discussed above in pages 14 to 24, its currency undervaluation could upset its tariff bindings pursuant to GATT Article II, which we propose to be sufficient for meeting this standard.

Notwithstanding, it must be voiced that most writers consider it unlikely that a breach of Article XV:4 will ever be found on the basis of currency devaluation. Furthermore, even considering such a breach to be found, Staiger and Sykes (2010)

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[61] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 607.

[62] Jorge Miranda, "Currency undervaluation as a violation of GATT Article XV:4 2010 THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), "Yuan to Fight About it? The WTO legality of China's exchange regime," http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 20/03/2011), p. 121.

make the sobering point that "if the WTO were now to rule that certain macroeconomic policies affecting trade are illegal, it would open a Pandora's box for political strife and tension within the system."[63]

The possibility, however, does exist and such a claim, if nothing else, would provide a much-needed jurisprudential definition of the terms of Article XV.

[63] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 608.

C. A CLAIM ON GATT ARTICLE XXIII:1 (B) IS LIKELY TO BE SUCCESSFUL AS THE COMBINATION OF PEGGING AND BUYING US SECURITIES NULLIFIES OR IMPAIRS LEGITIMATE MARKET ACCESS EXPECTATIONS

The undervaluation of the RMB could amount to a nullification or impairment of a benefit accruing to a WTO member directly, or indirectly under the GATT. This would constitute the so-called non-violation claim under GATT Article XXIII:1 (b).

First of all the applicability and the relationship with GATT Article XV will be examined before it will be tested, if the conditions of the claim are fulfilled.

1. Applicability and Relationship with GATT Article XV

It has to be mentioned that the Appellate Body and Panels have repeatedly stated that the non-violation claim "should be approached with caution and should remain an exceptional remedy."[64] Moreover, it was verified that, based on the wording of the Article, a claim may be successful "even if the measure 'conflicts' with some substantive provisions of the GATT 1994."[65] In this sense, "a measure may, at one and the same time, be inconsistent with, or in breach of, a provision of the GATT 1994 and, nonetheless, give rise to a cause of action under Article XXIII:1 (b)."[66]

Hence, the applicability or breach of GATT Article XXIII:1 (b) is not precluded by the violation of another substantive GATT provision.

With regard to the applicability of GATT Article XXIII:1 (b) and its relation to GATT Article XV authors claim that "frustrating the intent of the agreement" is - to have a purpose of its own - another kind of non-violation claim.[67] Following the

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[64] WTO, European Communities - Measures affecting Asbestos, Report of the Appellate Body (March 12, 2001), WT/DS135/AB/R, para. 186.
[65] WTO, European Communities - Measures affecting Asbestos, Report of the Appellate Body (March 12, 2001), WT/DS135/AB/R, para. 187.
[66] WTO, European Communities - Measures affecting Asbestos, Report of the Appellate Body (March 12, 2001), WT/DS135/AB/R, para. 187.
[67] Joel P. Trachtman, "Yuan to Fight About it? The WTO legality of China's exchange regime," in The US-Sino Currency Dispute: The US-Sino Currency Dispute: New Insights from Economics, Politics

argument that “exchange action” in GATT Article XV has a broader meaning and should be understood as “exchange measures” it is reasonable to understand GATT Article XV as *lex specialis* to the general non-violation claim of Article XXXIII:1 (b) GATT. Accordingly Article XXIII:1 (b) GATT would not be applicable, if the scope of Article XV was pertinent.[68] This assumption would make the success of a separate claim on Article XXIII GATT unlikely to succeed, if Article XV was applicable. This argument relies on a narrow application of the abovementioned AB’s ruling in EC-Asbestos. It is claimed that there the focus was based on the relation between the nullification or impairment claim and a conflict with a substantive provision rather than between two claims of a nullification or impairment nature.[69]

However, whether this assumption based on a narrow interpretation is indeed authoritative can be left open. Even if a Panel finds that the Chinese exchange rate policy does not constitute an “exchange action” under GATT Article XV, it could still be characterized as the more general “measure” of GATT Article XXIII:1 (b). Nevertheless, one could also interpret the abovementioned AB’s statement in the EC-Asbestos Report as reasoning on a totally independent applicability of GATT Article XXIII. The difference is insignificant for this memorandum as Article XXIII:1 (b) could either be claimed separately or in the alternative.

Assuming that Article XXIII applies, the Panel in Japan-Film verified that the non-violation claim under GATT Article XXIII:1 (b) requires the fulfillment of the following conditions: (i) the application of a measure by a WTO Member; (ii) a benefit accruing under the relevant agreement; (iii) expectations of a benefit that were legitimate; and (iv) nullification or impairment of the benefit as the result of the application of the measure.[70]

In the following paragraphs we shall proceed to the analysis of each of these requirements individually.

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and Law, edited by Simon Evenett (2010), http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 10/03/2011), p. 130.

[68] Joel P. Trachtman, “Yuan to Fight About it? The WTO legality of China’s exchange regime,” in The US-Sino Currency Dispute: The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, edited by Simon Evenett (2010), http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 10/03/2011), p. 130.

[69] Joel P. Trachtman, “Yuan to Fight About it? The WTO legality of China’s exchange regime,” in The US-Sino Currency Dispute: The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, edited by Simon Evenett (2010), http://www.voxeu.org/reports/currency_dispute.pdf (Accessed 10/03/2011), p. 130.

[70] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.41 and 10.76.

2. “Measure”

The Panel in Japan-Film affirmed that a “measure” does not need to have binding or compulsory nature as long as it entails a likelihood of compliance by private actors in a way so as to nullify or impair legitimately expected benefits within the purview of GATT Article XXIII:1 (b).[71] In this way, the Chinese policy of undervaluation even sets obligations for privates on how to trade the RMB.

Thus, the Chinese exchange rate policy even poses obligations and, hence, qualifies as measure under GATT Article XXIII:1 (b).

3. “Benefit”

In Japan-Film the Panel underlined that “benefit” referred to the legitimate expectations of improved market-access opportunities arising out of relevant tariff concessions.[72] While elaborating on the issue, the Panel referred to Article I (b) (i) GATT 1994 as the relevant provision relating to these concessions.[73]

When accessing to the WTO China engaged itself into wide ranging tariff concessions[74] and therefore improved market-access opportunities for the other Member States of the WTO setting grounds for expectations of benefit.

4. Legitimate Expectations

Furthermore, for a claim to be successful the Panel in EC-Asbestos identified that it is crucial to determine whether a party could have had a “legitimate expectation” of a given benefit.[75] The existence of a legitimate expectation is determined by questioning whether a certain measures of the accessing party could

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[71] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.49.
[72] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.62.
[73] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.62. The Panel then also cited the following Panel Reports: Australia — Ammonium Sulphate; Germany — Sardines; Uruguay — Recourse to Article XXIII; EC — Citrus; EEC — Canned Fruit; Japan — Semi-Conductors; EEC — Oilseeds I and US — Sugar Waiver.
[74] See Protocol of Accession of the People's Republic of China (November 23, 2001), WT/L/432.
[75] WTO, European Communities - Measures Affecting Asbestos and Asbestos-containing Products, Report of the Panel (September 18, 2000), WT/DS135/R, para. 8.285.

not have been reasonably anticipated at the time the tariff concession was negotiated.[76] It was held that the issue of reasonable anticipation needs to be addressed on a case-by-case basis and that it is "not sufficient to claim that a specific measure should have been anticipated because it is consistent with or a continuation of a past general government policy."[77]

a) Expecting a "Single and Managed Floating Exchange Rate"

During the accession negotiations China stated that it is using "a single and managed floating exchange rate regime based on supply and demand" since January 1, 1994.[78] As a "managed floating exchange rate system" is defined as "[t]he system under which a country's exchange rate is not pegged, but the monetary authorities try to manage it rather than simply leaving it to be set by the market"[79] one could argue that this statement could have given rise to expectations of something more liberal than the *de facto* peg the Chinese are pursuing in their exchange rate policy.[80]

Even though there might be a gap between official statements and actions, it is far-fetched to consider this position as creating a legitimate expectation. The practice of "a managed floating exchange rate system" was already implemented in 1994 and the statement as such does not give hint to any change after the accession.

Therefore, the peg alone would not seem to suffice for such a conclusion, as certain authors have concluded.[81]

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[76] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.77.
[77] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.79.
[78] The Chinese representative, WTO, Report of the Working Party on the Accession of China to the WTO (November 10, 2001), WT/MIN(01)/3, para. 31.
[79] The Oxford Dictionary of Economics, „managed floating exchange rate", http://www.enotes.com/econ-encyclopedia/managed-floating-exchange-rate (2003), (accessed March 30, 2011).
[80] See as an example for analysis: FOREXBLOG on the Chinese RMB, http://www.forexblog.org/2010/03/chinese-yuan-still-pegged-and-us-treasury-purchases-continue.html (accessed March 30, 2011).
[81] Dukgeun Ahn, "Is the Chinese exchange-rate regime "WTO-legal"?", THE US-SINO CURRENCY DISPUTE: NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW (2010), p. 139.

b) Expecting an Appreciation

The previous assumption is reversed when considering the additional element of China's massive acquisition and retention of US Treasuries and Agencies (see Figure 1 and 2 below). The Panel in Japan-Film confirmed that under special circumstances a combination of measures needs to be taken into account:

> "[I]t is not without logic that a measure, when analyzed in isolation, may have only very limited impact on competitive conditions in a market, but may have a more significant impact on such conditions when seen in the context of — in combination with — a larger set of measures. Notwithstanding the logic of this theoretical argument, however, we are sensitive to the fact that the technique of engaging in a combined assessment of measures so as to determine causation is subject to potential abuse and therefore must be approached with caution and circumscribed as necessary."[82]

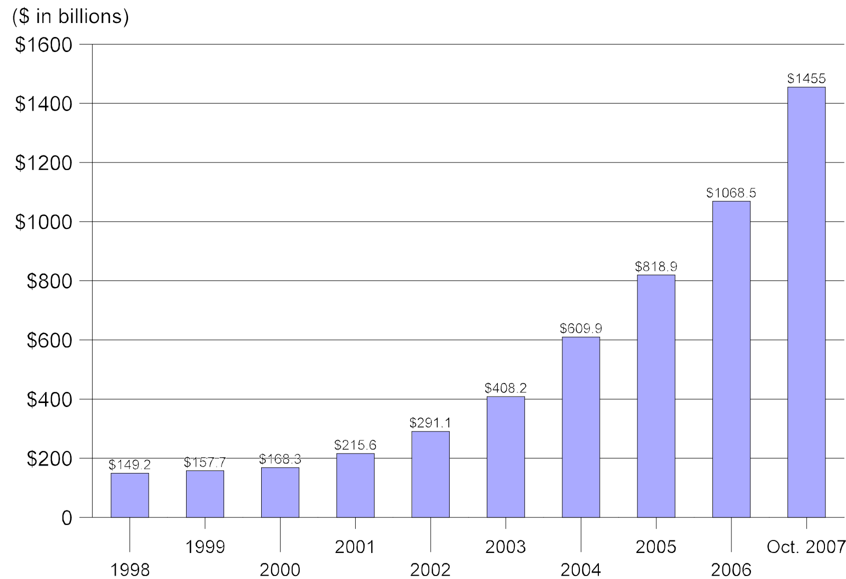
Considering the impact of the combination of both government actions (the peg and the massive acquisition of bonds) on the access to the Chinese market they necessarily have to be considered as jointly. As described above China declared that it is basing its exchange rate regime "on supply and demand". With the heavy increase of exports and, hence, an much higher demand to exchange export gained USD into RMB by Chinese exporters, an appreciation of the RMB could have legitimately been expected.[83] The limit of fluctuation of 0.3 per cent of the reference rate between USD and RMB from one day to the other, as explained by the Chinese representative, would have allowed at least an appreciation at this rate.[84]

In the contrary, China started a practice of massive acquisition of US titles only in 2001 - after its accession to the WTO (see Figure 2) to prevent appreciation through directly influencing "supply and demand". Before, China was a net issuer of debt, whereas after its accession this policy reversed. This policy is historically unprecedented and could therefore not be reasonably anticipated by any WTO

[82] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.86.
[83] See also Morris Goldstein and Nicholas Lardy, "China's Exchange Rate Policy Dilemma", THE AMERICAN ECONOMIC REVIEW, Vol. 96, No. 2 (May, 2006), p. 425.
[84] The Chinese representative, WTO, Report of the Working Party on the Accession of China to the WTO (November 10, 2001), WT/MIN(01)/3, para. 31.

member state. Hence, member states could legitimately expect that China would not engage in such kind of interrelating governmental measures.

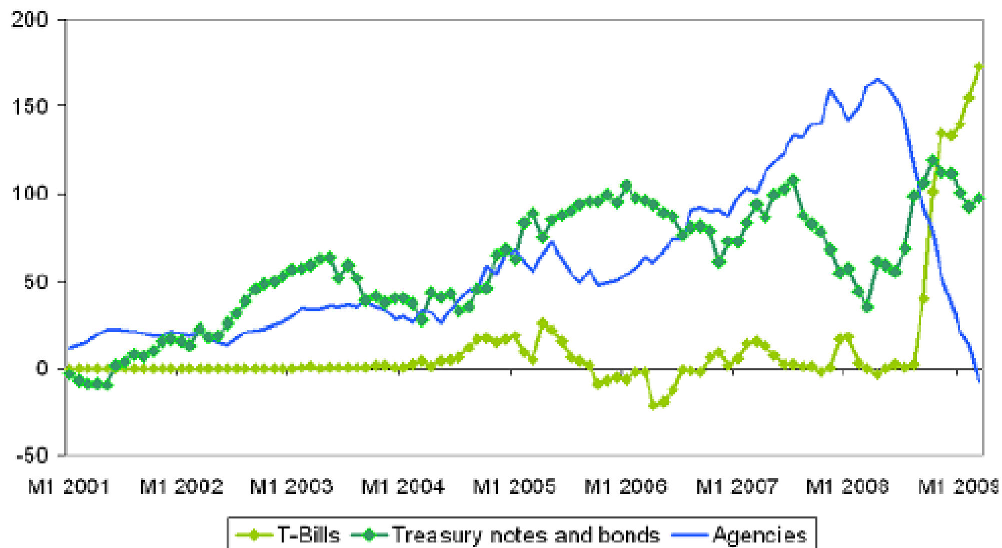
Figure 1. China's Foreign Exchange Reserves: 1998-October 2007



Source: International Monetary Fund, International Financial Statistics, various years.

Figure 2

Estimated Chinese purchases of Treasuries and Agencies
Rolling 12m sums, $ billion



Graph published by Brad Setser on the Council on Foreign Relations website (http://blogs.cfr.org/setser/2009/05/17/we-hate-you-guys-but-there-is-nothing-much-we-can-do/, assessed March 30, 2010)

5. "Nullification or Impairment of the Benefit by the Measure"

For a non-violation claim to be successful, China must also have nullified or impaired the legitimately expected benefit of WTO members. The Panel in Japan-Film defined this requirement as "upsetting the competitive relationship" between domestic and imported products and held that the complaining party "must show a clear correlation between the measures and the adverse effect on the relevant competitive relationships".[85] The Panel further elaborated that the casual link must at least be a *de minimis* contribution to nullification or impairment by the measure.[86]

6. De minimis Contribution to Nullification or Impairment

For the past several years, there has been an excessive demand for RMB and, at the same time a high amount of supply of USD in China at the prevailing exchange rate of the peg.[87] In order for Chinese central bank to maintain the peg, it had to increase its foreign reserves by buying in exchange for newly printed RMBs. As seen in Chart 1, foreign reserves grew from USD 75 billion in 1995 to USD 168 billion in 2000 to USD 2,131 billion in 2006.[88] This change in policy fundamentally increased the manipulation of the exchange rate, raising the peg-policy to a whole new level of undervaluation. Only by acquiring these enormous amounts of foreign reserves China was able to keep its peg and undervalue its currency.[89]

The peg alone does not constitute a nullification of legitimate expectations. The undervaluation (peg and purchase of US securities) implies that prices for domestic goods remain artificially low compared to their value in other currencies. In this way, imported products are not only loaded with Chinese applied tariffs but also with an "exchange extra" making them unattractive for Chinese consumers. This

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[85] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.83.
[86] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.83.
[87] CRS Report for Congress, "China's Currency: Economic Issues and Options for U.S. Trade Policy", (January 9, 2008), Order Code RL32165, p. 8.
[88] Wayne M. Morrison and Marc Labonte, "China's Holdings of U.S. Securities: Implications for the U.S. Economy", CRS Report for Congress (July 30, 2009), p. 2; CRS Report for Congress, "China's Currency: Economic Issues and Options for U.S. Trade Policy", (January 9, 2008), Order Code RL32165, p. 8.
[89] CRS Report for Congress, "China's Currency: Economic Issues and Options for U.S. Trade Policy", (January 9, 2008), Order Code RL32165, p. 8.

upsets competition as it favors Chinese domestic products over imports. Foreign producers expected to export more due to lower tariffs after China's WTO accession. The lower value of the RMB infringed this prospect as it neutralized increased market access opportunities.

Although China keeps its tariffs in par with its bound rates, the added "exchange extra" surpasses them, thus nullifying and impairing the legitimate expectation created by the Chinese tariff and subsidy concessions.[90] This clearly constitutes a *de minimis* contribution to nullification or impairment.

7. No Intent necessary

The same Panel recognized that an intent is not necessary for a claim under GATT Article XXIII:1 (b).[91] Only the impact of the measure is relevant, which - as shown above - is discriminative.

8. Conclusion

If an interpretation of "exchange action" is favored that does not encompass the Chinese exchange rate policy, a claim could alternatively or additionally be based on GATT Article XXIII:1 (b). By its twofold set of measures – pegging the RMB and purchasing US assets worth trillions – China could be said to nullify and impair the WTO member states' legitimate expectations of benefits.

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[90] See V. A. for an analysis on the compliance of the Chinese exchange rate policy with GATT Article II and V. D. for subsidies.

[91] WTO, Japan - Measures Affecting Consumer Photographic Film and Paper, Report of the Panel (March 31, 1998), WT/DS44/R, para. 10.86.

D. IT IS UNLIKELY THAT THE CHINESE EXCHANGE RATE POLICY AMOUNTS TO A PROHIBITED OR ACTIONABLE SUBSIDY

The Chinese currency manipulation could be challenged before the DSB, if the measure represents a prohibited or actionable subsidy under the Subsidies and Countervailing Measures Agreement (SCM).

For both kinds of subsidies two requirements need to be fulfilled: (i) it must contain a governmental "financial contribution" (SCM Article 1.1 (a)); (ii) confer a "benefit" on its recipient (SCM Article 1.1 (b)). A prohibited subsidy needs to fulfill the requirements of SCM Article 3 and actionable subsides must be specific under SCM Article 1.2 and have adverse effects according to GATT Article 5.

1. Financial Contribution

SCM Article 1.1 (a) lists four methods of how a government can contribute financially to a business: (i) a direct transfer of funds, potential direct transfer of funds or liabilities; (ii) government revenue that is otherwise due is foregone or not collected; (iii) a government provides goods or services other than general infrastructure, or purchases goods; or (iv) a government makes payments to a funding mechanism.

The Panel in US — Export Restraints concluded that the list provided under SCM Article 1.1 (a) is indeed finite.[92] It is unclear among scholars, if the Chinese undervaluation amounts to a financial contribution.

As we will examine further below, the outcome changes when focusing on the only relevant relationship at hand - the one between private businesses and their respective government and not the government's currency exchange with other countries on international financial markets.

[92] WTO, United States – Measures Treating Exports Restraints as Subsidies, Report of the Panel, (June 29, 2001), WT/DS194/R, para. 8.73.

a) SCM Article 1.1 (a) (i)

The exchange rate policy could amount to a "direct transfer of funds" under SCM Article 1.1. (a) (i), since the Chinese government sets the rate of exchange by fiat, and prints the money to fund the transaction.[93] For each USD the Chinese exporter exchanges for RMB he gets a higher amount than a free floating, necessarily higher, RMB would provide.[94]

This could constitute a direct financial contribution of the Government to private entities in the sense of SCM Article 1.1 (a) (i). Nevertheless, the transfer of funds also needs to be "direct". The oxford dictionary refers to "direct" as "without intervening factors or intermediaries".[95] One could argue that buying treasury bonds as a measure to grant more RMB per USD has no straight link to the conferral of a benefit. Nevertheless, the Panel in Brazil-Airports found that when a governmental action gives rise to a benefit, a subsidy is conferred irrespective of whether any payment occurs.[96] Additionally, one can draw from the Second Report on Anti-Dumping and Countervailing Duties stating that "[i]t was agreed that the word 'subsidies' covered not only actual payments, but also measures having an equivalent effect"[97] one should understand the elements of a subsidy in broader terms with special emphasis on their effects. That the exchange itself usually might happen in a private Bank arguably also does not change the result - it acts only as an agent without any additional capacity.[98] This is similar to the way a government may set a customs tariff, which is collected by a transportation company (e.g. Fedex), likewise, exchange rates are set by the government and fact carried out by private companies

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[93] China Currency Coalition, Petition for Relief under Section 301(a) of the Trade Act of 1974, as amended, (September 9, 2004), p. 60.
[94] Provided a 25 % undervaluation of the RMB can be found.
[95] Oxford Dictionaries, Entry on "Direct", http://oxforddictionaries.com/view/entry/m_en_gb0228140#m_en_gb0228140, (Accessed 20/05/2011).
[96] WTO, Brazil – Export Financing Programme for Aircraft, Report of the Panel, (April 14, 1999) WT/DS46/R, adopted as modified by Appellate Body Report, (August 20, 1999), para. 7.68.
[97] WTO, Second Report on Anti-Dumping and Countervailing Duties, L/1141, (May 27, 1960), BISD 9S/194, 200, para. 34.
[98] Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 27; WTO, United States – Measures Treating Exports Restraints as Subsidies, Report of the Panel (June 29, 2001), WT/DS194/R, para. 8.53: "[...] we believe that the intention of subparagraph (iv) is to avoid circumvention of subparagraphs (i)-(iii) by a government simply by acting through a private body."; Tietje, WTO Agreement on Subsidies and Countervailing Measures, 8; Pitschas, in: Prieß/Berrisch (Hrsg.), WTO-Handbuch, B.I.12., para. 61.

does not alter the situation. Furthermore, it would only infringe the intent of the subparagraphs of Article 1.1 (a) - and especially subparagraph (iv) -, if a government could circumvent its obligations by instructing a private party with such a process.[99] A free market for currency exchange does not exist in China and the private intermediary is obliged to exchange under officially provided conditions.[100]

In addition, the AB in Canada – Civil Aircraft stated that the focus of the inquiry indeed needs to be on the recipient rather than the government:[101]

> "This provides textual support for the view that the focus of the inquiry under Article 1.1 (b) of the SCM Agreement should be on the recipient and not on the granting authority. [...] The structure of Article 1.1 as a whole confirms our view that Article 1.1(b) is concerned with the `benefit´ to the recipient, and not with the `cost to government´."[102]

Therefore, one could conclude that as long as the recipient enjoys a certain amount of extra RMB for USD the financial contribution of the government as a condition is fulfilled.

An alternative possibility to find a financial contribution is to consider that no direct contribution between the government and the recipient is needed. If one looks at the actual international exchange transactions, they do not entail any "direct

[99] Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 27; WTO, United States – Measures Treating Exports Restraints as Subsidies, Report of the Panel (June 29, 2001), WT/DS194/R, para. 8.53: "[...] we believe that the intention of subparagraph (iv) is to avoid circumvention of subparagraphs (i)-(iii) by a government simply by acting through a private body."; Tietje, WTO Agreement on Subsidies and Countervailing Measures, 8; Pitschas, in: Prieß/Berrisch (Hrsg.), WTO-Handbuch, B.I.12., Rn. 61.

[100] Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 27.

[101] Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 29; Slotboom, Subsidies in WTO Law and in EC Law, 517, p. 535; Ohlhoff, EuZW 2000, 645, p. 647.

[102] WTO, Canada – Measures Affecting the Export of Civilian Aircraft, Report of the Appellate Body (August 2, 1999), WT/DS70/AB/R, para. 154 et seq.

transfer of funds” to the exporting Chinese businesses as they are used to trade in the foreign exchange market.[103]

At the same time no such direct link is requires under the terms of SCM Article 1.1 (a). It is well-established that subsidies may arise “upstream” in a chain of production and be passed downstream in the form of lower prices from input suppliers.[104] Some also argue that “spill-over-effects” are also encompassed by SCM Article 1.1 (a) (i).[105] Therefore, one can conclude that as long as there is a transaction involving the transfer of funds, one might argue that a financial contribution exists.[106] In this way one could also be able to find a financial contribution from the broader economic view.

b) SCM Article 1.1 (a) (iii)

It could also be argued that, under the terms of SCM Article 1.1. (a) (iii), a stable currency represents a ‘service’ in the financial/insurance sector other than infrastructure. One could think about decreased costs for exporters as there is no need for hedging against currency fluctuations. The Chinese government intervenes in the currency market by exchanging RMBs with USDs so as to create a stable currency and avoid inflation and value losses.[107] However, this would only be reasonable if the exchange rate policy does not represent “general infrastructure”.

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[103] Robert Staiger and Alan Sykes, “‘Currency Manipulation’ and World Trade”, Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 32.

[104] Robert Staiger and Alan Sykes name the US Softwood Lumber case as providing a good example: below market prices for timber harvesting rights are said to result in a subsidy to sawmills unaffiliated with the harvesters, Robert Staiger and Alan Sykes, “‘Currency Manipulation’ and World Trade”, Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 32 - also for indirect contributions: Stewart, Terence P./Dwyer, Amy S./Stirk, J. Daniel, Response to Bacchus/Saphiro Analysis of WTO-Consistency of Hunter-Ryan Bill (HR 1498) (September 22, 2006), http://www.chinacurrencycoalition.org/pdfs/Memo_on_Response_to_RH_Bill.pdf (accessed March 30, 2011); Ohlhoff, EuZW 2002, 549 (553); China Currency Coalition, Section 301, 60; Becker, Das WTO-Subventionsübereinkommen, 32.

[105] Ohlhoff, “Entwicklung der Rechtsprechung zum WTO-Recht in den Jahren 2000 und 2001”, EuZW (2002), p. 553.

[106] Robert Staiger and Alan Sykes, “‘Currency Manipulation’ and World Trade”, Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 32.

[107] Martina Franke, “Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts”, BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 30; Check: Hartquist, U.S. Economic Relations with China, 11; Wilkey, Richard L./Hassey, L. Patrick/O´Shaughnessy, M. Brian,

The Panel in EC-Aircraft considered that the term "general infrastructure", "taken in its ordinary and natural meaning, refers to infrastructure that is not provided to or for the advantage of only a single entity or limited group of entities, but rather is available to all or nearly all entities"[108]. The exchange rate policy does create an advantage for almost every entity and needs as such to be considered as general infrastructure.

Hence, the Chinese exchange rate policy is unlikely to be seen as a financial contribution in the sense of SCM Article 1.1 (a) (iii).

c) SCM Article 1.1 (a) (iv)

As China fixes the exchange rate so that private entities can only exercise currency exchange to the pegged rate with the USD, it is also possible to subsume this obligation under SCM Article 1.1 (a) (iv), which is designed to avoid circumvention of (i) to (iii) by operating through a private body.[109] The People's Bank of China directs the private banks by providing more RMB for USD than the 'normal' undistorted rate would provide through buying treasury bond and setting the hen 'created' reference rate at the interbank forex market.[110] Private banks are therefore only passing money through. However, as these entities have practically no discretion the same issues and problems arise as they were mentioned in the preceding paragraphs.

d) Partial Conclusion

A wider understanding of "financial contribution" in the sense of SCM Article 1.1 (a) is needed to convince a panel that this necessary element of a subsidy is met by the exchange policy of China.

Letter of September 21, 2006 to John Engler, President of the National Association of Manufacturers, (http://www.nam.org/s_nam/index. asp) (Accessed 19/03/2011).

[108] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel (June 30, 2010), WT/DS316/R, paras 7.1015-1044.

[109] WTO, United States – Measures Treating Exports Restraints as Subsidies, Report of the Panel, (June 29, 2001), WT/DS194/R, para. 8.53; Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 30.

[110] The Chinese representative, WTO, Report of the Working Party on the Accession of China to the WTO (November 10, 2001), WT/MIN(01)/3, para. 31.

2. Benefit

The second main element of a subsidy is a "benefit" according to SCM Article 1.1 (b). For the Appellate Body in Canada-Aircraft, the "ordinary meaning of 'benefit' clearly encompasses some form of advantage"[111] and that one needs to determine "whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution."[112]

It also stated that the "only logical basis for determining the position the recipient would have been in absent the financial contribution is the *market*"[113] and that "the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[114]

Following the view that one has to focus on the process of the exporter exchanging its USDs into RMBs in China, the condition of a better financial situation needs to be achieved on the side of the private entity.[115] As already concluded, the recipient receives a higher amount of RMB than it would without the fixed exchange rate.

a) Domestic Market Comparison

However, the basis for this test is, as set out above by the Appellate Body, a market comparison. The exchange rate is fixed everywhere in China, thus a domestic market comparison in the form the AB required is not possible.

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[111] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 149.
[103] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 149.
[113] Emphasis added, WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 149.
[114] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 157.
[115] Tim Becker, DAS WTO-SUBVENTIONSABKOMMEN, p. 32; Frank Wolfram, Exportkreditförderung (2004), p. 251.

b) *Utilization of Benchmarks other than in the Country of Provision*

One could think of a comparison with other markets, which could be possible if the conditions of SCM Article 14 (d), Article 15 (b) of the Chinese protocol of accession would be fulfilled. As an alternative one could also think of a hypothetical market comparison, if a worldwide distortion exists.

(1) SCM Article 14 (d) and Article 15 (b) of the Protocol of Accession

A trans-border comparison of goods, for instance, was considered appropriate by the AB, under SCM Article 1.1 (a) (iii), in relation to the application of SCM Article 14 (d) "when it has been established that those private prices are distorted, because of the pre-dominant role of the government in the market as a provider of the same or similar goods."[116]

In the recent Report on US-AD/CVD the AB confirmed this finding and concluded with regard to the Chinese market that

> "an investigating authority may reject in-country private prices if it reaches the conclusion that these are too distorted due to the predominant participation of the government as a supplier in the market, thus rendering the comparison required under Article 14(d) of the *SCM Agreement* circular. It is, therefore, price distortion that would allow an investigating authority to reject in-country private prices, not the fact that the government is the predominant supplier *per se*."[117]

However, as stated above SCM Article 1.1 (a) (iii), which is the prerequisite for SCM Article 14 (d), is not directly applicable to exchange rate undervaluation. The exchange rate policy is not a service other than infrastructure and therefore Article 14 (d) is not applicable.

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[116] WTO, United States – Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada, Report of the Appellate Body (January 19, 2004), WT/DS257/AB/R, para. 103 et seq.

[117] WTO, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, Report of the Appellate Body (March 11, 2011), WT/DS379/AB/R, para. 446.

A rule such as, for example, Article 2.2 in the Anti-Dumping Agreement that allows for a general comparison with another market does not exist in the SCM. However, in the particular case of China the protocol of accession provides in its Article 15 (b) the possibility for comparisons with markets of third States. The Article provides:

> "In proceedings under Parts II, III and V of the SCM Agreement, when addressing subsidies described in Articles 14(a), 14(b), 14(c) and 14(d), relevant provisions of the SCM Agreement shall apply; however, if there are special difficulties in that application, the importing WTO Member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks. In applying such methodologies, where practicable, the importing WTO Member should adjust such prevailing terms and conditions before considering the use of terms and conditions prevailing outside China." [118]

Even if one would argue that the conditions for this trans-border comparison are fulfilled due to the restriction of money transfer, there is no other real existing exchange rate for the RMB even outside China, which could be referred to in order to test if a benefit was conferred to the recipient.[119]

Others take a view from the macroeconomic perspective to reach the required benefit.[120] They conclude that since each USD is equal to 6.59 RMB, consumers in the countries that import Chinese products would be able to purchase these products

[118] Protocol on the Accession of the People's Republic of China, WT/L/432 (November 23, 2001).
[119] Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 32.
[120] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 47.

for less than comparable products produced in the United States[121] and Chinese exporters would, therefore, have a cost advantage over U.S. producers.[122]

However, this approach might be too disconnected to the Chinese market and its benchmarks and the macroeconomic method used rather unlikely followed by a Panel.

(2) Rejection and Reconstruction of the USD-RMB exchange rate

Another possibility to find an advantage is to compare the situation Chinese exporters face with the un-manipulated value of the RMB. This could be possible by rejecting the Chinese exchange rate and reconstruct under undistorted conditions. The AB in China-ADCVD confirmed that "in-country private prices [can be rejected] if [an investing authority] reaches the conclusion that these are too distorted due to the predominant participation of the government as a supplier in the market."[123] The AB added that

> "[i]t is, therefore, price distortion that would allow an investigating authority to reject in-country private prices, not the fact that the government is the predominant supplier *per se*. There may be cases, however, where the government's role as a provider of goods is so predominant that price distortion is likely and other evidence carries only limited weight."[124]

Even though the AB refers to a case, in which goods were the objects of the analysis, the overarching issue is similar. The exchange rate, and, hence, prices in China are distorted by enormous governmental intervention as shown above extensively already. It is only not possible to find suitable comparisons for the calculation of the benefit under the SCM, because the RMB distortion is so strong that

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[121] Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 19/03/2011), p. 20.

[122] Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 19/03/2011), p. 20.

[123] WTO, United States-Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, Report of the Appellate Body, (March 11, 2011), WT/DS379/AB/R, para. 446.

[124] WTO, United States-Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, Report of the Appellate Body, (March 11, 2011), WT/DS379/AB/R, para. 446.

it affects the whole world. Therefore, the value of the RMB needs to be rejected and reconstructed in order to analyze, whether a benefit exists. Such a partly hypothetical reconstructions are not alien to the SCM as shown above. Through a comparison with prices in third countries and the calculation of the 'real' value of the RMB that according to our premise should be 25 % higher, a calculation should be feasible. By receiving more RMB per USD than without the Chinese monetary policy one could conclude that exchanging privates receive an advantage, hence a benefit.

However, it needs to be pointed out that this argument was not yet tested in front of a WTO Panel and that the finding of an exact undervaluation amount is difficult.

(3) Partial Conclusion

Even though distortion might quite likely be possible to show, due to the above stated reasons it remains uncertain, whether a Panel would find an advantage for Chinese Exports and, hence, a benefit according to the SCM agreement.

3. Prohibited Subsidies

The subsidy also needs to be specific, according to SCM Article 2. The subsidies that fall under SCM Article 3 - prohibited subsidies - are deemed specific automatically under SCM Article 2.3. SCM Article 3 contains two categories: (i) export subsidies; and (ii) subsidies contingent upon the use of domestic over imported goods. The Chinese exchange rate policy applies countrywide and is established by law. It is neither *de jure* or *de facto* contingent on the use of domestic over imported goods.[125] However, the policy could amount to a *de jure* or *de facto* export subsidy.

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[125] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 47; Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 19/03/2011), p. 22; Martina Franke, "Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts", BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 33.

a) *Illustrative Subsidy of Annex I to the SCM*

At first glance, one could find that the Chinese exchange rate policy amounts to either a Currency retention scheme or any similar practice which involves a bonus on exports under Annex I (b), or a government credit program that ensure exports against exchange rate risk laid down in Annex I (j) SCM. However, it is much more likely that a Panel would not find that it amounts to one of the illustrative examples of Annex I.

A currency retention scheme permits certain exporters to retain a portion of receipts from foreign exchange earnings notwithstanding a general rule for residents to surrender receipts of foreign exchange to local banks, or the central bank, in exchange for local currency.[126] The Chinese policy does not give any kind of different treatment to its domestic exporters and does not oblige people to surrender foreign currency.[127]

It does also not amount to an exchange risk program in the sense of SCM Annex I (j). Even though it might finally limit the need for hedging by private businesses, one can hardly economically speak of "costs and losses" for the government and a premium rate program to eliminate this kind of risks. [128]

Therefore, the Chinese exchange rate program cannot be subsumed as one of the examples of the illustrative list in the SCM Annex I.

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[126] Deborah E. Siegel "Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements" (2002), "The American Journal of International Law", Vol. 96, 2002, p. 617; Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 19/03/2011), p. 26.

[127] See also Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 19/03/2011), p. 26.

[128] Marc Benitah, "China's Fixed Exchange Rate for the Yuan: Could the United States Challenge It in the WTO as a Subsidy?", ASIL Insights (2003), http://www.asil.org/insigh117.cfm (Accessed 01/04/2011).

b) De Facto Export Subsidy

SCM Article 3.1 (a) expressly provides for the possibility of a *de facto* prohibited export subsidy, that the Chinese exchange rate policy could amount to.[129] Original footnote 4 to the Article clarifies:

> "[the *de facto* 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."

The specific facts of the case also need to be considered on a case-by-case basis.[130] The Appellate Body in Canada-Aircraft noted that "satisfaction of the standard for determining a *de facto* export contingency set out in footnote 4 requires proof of three different substantive elements: (i) the 'granting of a subsidy'; (ii) that it be, 'tied to …'; and (iii) an 'actual or anticipated exportation or export earnings'."[131]

The first requirement is met, if the granting authority imposed a condition based on export performance in providing the subsidy.[132] The Chinese authorities set up the fixed exchange rate that entities enjoy when exchanging USD to RMB. It therefore seems plausible to conclude that the first requirement is fulfilled.

Secondly, the AB interprets "tied to" in a way that the facts must 'demonstrate' that the granting of a subsidy is tied to or contingent upon actual or anticipated exports.[133] It concluded that "it does not suffice to demonstrate solely that a government granting a subsidy anticipated that exports would result."[134] More RMB

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[129] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 48.
[130] WTO, Australia - Subsidies provided to Producers and Exporters to Automotive Leather, Report of the Panel, (May 25, 1999), para. 9.57.
[131] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 169.
[132] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 170.
[133] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 171.
[134] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 171.

than under a free floating rate are provided only for those who were able to earn in USD, which still remains the main currency exports are transacted.[135] Hence, also the “tied to” requirement is likely to be fulfilled as almost exclusively exporters are able to earn in USD that they are able to exchange in RMB.

Thirdly, the facts considered must demonstrate that granting or maintenance of the subsidy is conditioned upon actual or anticipated exportation or export earnings.[136] Since the amount of “extra” RMB in relation to the USD is proportional to export volumes and thus varies from one exporter to another, it is reasonable to regard such a subsidy as being an “actual or anticipated exportation or export earnings”.

A remaining question is whether a *de facto* subsidy needs to be contingent solely on export performance. The fact that the granting of additional RMB is also available, for instance for tourists, would then be able to challenge the existence of a prohibited subsidy. The wording of SCM Article 3.1 does not provide for this requirement.[137] The AB accordingly concluded in United States - Tax Treatment that “the fact that the subsidies granted in the second set of circumstances might not be export contingent does not dissolve the export contingency arising in the first set of circumstances.”[138]

Due to SCM Article 2.3’s automatic determination that subsidies under SCM Article 3 are to be deemed specific this element does not need to be looked at any further.

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[135] See also: Claus D. Zimmermann, “Currency Manipulation and the Paralysis of the Law”, (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 49.

[136] WTO, Measures affecting the Export of Civilian Aircraft, Report of the Appellate Body, (August 2, 1999), WT/DS70/AB/R, para. 172, reaffirmed by WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.630.

[137] See also Martina Franke, “Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts”, BEITRÄGE ZUM TRANSNATIONALEN WIRTSCHAFTSRECHT, Heft 77, http://www.wirtschaftsrecht.uni-halle.de/sites/default/files/altbestand/Heft_77.pdf (Accessed 19/03/2011), p. 35.

[138] WTO, United States – Tax Treatment for "Foreign Sales Corporations" (Article 21.5 DSU – EC), Report of the Appellate Body (January 14, 2002), WT/DS108/AB/RW, para. 119; see also WTO, United States – Subsidies on Upland Cotton, Report of the Appellate Body (March 3, 2005), WT/DS267/AB/R, para. 572 et seq.: “Furthermore, we agree with the Panel's conclusion that the fact that the subsidy is also available to domestic users of upland cotton does not `dissolve´ the export-contingent nature of the Step 2 payments to exporters.”

4. Actionable Subsidy

The Chinese exchange rate policy could also amount to an actionable subsidy.

a) Specificity

Besides being a *de facto* export subsidy - it could be argued that the exchange rate policy is *de facto* specific in the sense of SCM Articles 2.1 (c). Rather than focusing solely on exporting industries actionable subsidies, one could argue that the exchange rate policy is *de facto* specific on industries that regularly exchange USD to RMB in the sense of SCM Article 2.1 (a). However, the vast majority of authors deny that this group would be sufficiently specific regarding the Chinese exchange rate policy. Under this approach no actionable subsidy is found and the only subsidy to be found would be an export subsidy.

b) Adverse Effects

An actionable subsidy must also cause adverse effects to the interests of other Members according to GATT Article 5. Those effects are caused if there is (i) injury to the domestic industry of another Member; (ii) nullification or impairment of benefits accruing to another Member; or (iii) serious prejudice to the interests of another Member.

(1) Injury to the domestic Industry

As the original footnote to Article 5 (a) provides the term "injury to the domestic industry" is used in the same sense as it is used in Part V, and, hence, meaning as in SCM Article 15. Therefore, the determination shall be based on:

> "positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products."

Furthermore, according to Article 15.4 the inquiry shall “include an evaluation of all relevant economic factors” such as *inter alia* changes in sales, market share, profits, productivity, employment and wages. Moreover, Article 15.5 requires that the subsidized imports caused injury, which must be demonstrated on an examination of all relevant evidence as well as evidence that other factors may be causing injury. Foreign like products can be identified by similar physical and non-physical characteristics of the products and how the specific industry itself has analyzed market segmentation such as in other GATT provisions including the phrase ‘like product’ as for example GATT Article III:2.[139] ‘Positive evidence’ relates to

> „the quality of the evidence that authorities may rely upon in making a determination. The word 'positive' means, to us, that the evidence must be of an affirmative, objective and verifiable character, and that it must be credible.“[140]

The AB in US – Hot-Rolled Steel summarized the requirements for an ‘objective examination’ as follows:

> “an 'objective examination' requires that the domestic industry, and the effects of [subsidized] imports be investigated in an unbiased manner, without favouring the interests of any interested party, or group of interested parties, in the investigation. The duty of the investigating authorities to conduct an 'objective examination' recognizes that the determination will be influenced by the objectivity, or any lack thereof, of the investigative process.”[141]

With regard to the injury determination Appellate Body in Thailand – H-Beams concluded the fundamental importance of AD Article 3.1 in this determination and the steps that need to be followed in the analysis:

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[139] WTO, Indonesia - Certain Measures Affecting the Automobile Industry, Report of the Panel, (July 23, 1998), (WT/DS54,55,59,64/R), paras. 14.163-204.
[140] WTO, European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea, Report of the Panel, (June 17, 2005), WT/DS299/R, para. 7.271.
[141] WTO, United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, Report of the Appellate, (July 24, 2001), WT/DS184/AB/R, para. 193.

> "Article 3 as a whole deals with obligations of Members with respect to the determination of injury. Article 3.1 is an overarching provision that sets forth a Member's fundamental, substantive obligation in this respect. Article 3.1 informs the more detailed obligations in succeeding paragraphs. These obligations concern the determination of the volume of dumped imports, and their effect on prices (Article 3.2), investigations of imports from more than one country (Article 3.3), the impact of dumped imports on the domestic industry (Article 3.4), causality between dumped imports and injury (Article 3.5), the assessment of the domestic production of the like product (Article 3.6), and the determination of the threat of material injury (Articles 3.7 and 3.8). The focus of Article 3 is thus on *substantive* obligations that a Member must fulfil in making an injury determination."[142]

Therefore, taken Brazil as an hypothetical example would have to undertake a two-step analysis of the question of injury.[143] First, whether a domestic industry, potentially steel or other 'heavy industries', suffers a material injury by the factors listed in SCM Article 15.4, which are not exhaustive[144]:

> "an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment, wages, growth"

In the second step, a WTO member country would need to determine whether such material injury is caused by the subsidized imports, in view of the volumes and price effects of such imports and their consequent impact on the domestic industry. The consideration of 'volume' according to SCM Article 15.2 requires countries to

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[142] WTO, Thailand–Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland, Report of the Appellate Body, (April 5, 2001), WT/DS122/AB/R, para. 106.
[143] See for a detailed analysis WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.2083 et seq.
[144] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.2083.

analyze "whether there has been a significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing Member". And with respect to ‘the effect of the subsidized imports on prices’, consideration must be given to

> "whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree."

Hence, an importing WTO member needs to show that imports relating to a specific subsidized product increased significantly and that these imports undercut prices or depressed them in the member’s market. Following that, the causal link has to be established between the subsidies in form of the exchange rate currency and the injury of the imoporting country’s industry. This could be done by objectively showing that the distorted RMB-USD exchange rate allowed Chinese exporters to offer products cheaper than like foreign domestic products in the foreing market, which accordingly hurt domestic industry.

(2) Nullification or Impairment

According to the Panel in US - Offset Act ("Byrd Amendment") nullification or impairment has the same meaning as in GATT Article XXIII[145] and that footnote 12 to Article 5(b) of the SCM Agreement provides that

> “[t]he term “nullification or impairment” is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.“

[145] WTO, United States - Continued Dumping and Subsidy Offset Act of 2000, Report of the Panel (September 16, 2002), WT/DS217,234/R, para. 7.122.

A WTO member would need to show that by subsidizing China upsets the competitive relationship between Chinese domestic and imported products. This could specifically be shown by verifying that China infringed the benefits of tariff concessions that foreign exporters expected through keeping Chinese products at an artificially lower price for Chinese consumers than imported ones, and as such making foreign products less competitive. See for a more detailed elaboration on nullification or impairment under section V.C.(v) of this memorandum.

(3) Serious Prejudice

SCM Article 6 defines "serious prejudice" in a non-cumulative list. SMC Article 6.3 provides that there are different options to show serious prejudice:

> "(a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member; (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market; (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market; (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted."

The Panel in US-Cotton found that the Chapeau of SCM Article 6.3 would not constitute another condition to be fulfilled.[146]

[146] WTO, United States - Subsidies on Upland Cotton, Report of the Panel, (December 18, 2007), (WT/DS267/RW), para. 7.1390.

(a) First option – Showing Displacement or Impediment of the Imports into the Market of the subsidizing Member

Under the first option the Panel found in Indonesia-Autos that displacement in SCM Article 6.3 (a) relates to “a situation where sales volume has declined, while impedance relates to a situation where sales which otherwise would have occurred were impeded”[147], which accordingly would need to be shown for an foreign importer into China. Market share data is considered a highly relevant evidence for this analysis and should, therefore, be used.[148]

(b) Second Option – Showing Displacement or Impediment of the Exports from a third Country Market

The second option, SCM Article 6.3. (b), addresses the same phenomenon, only in different markets.[149] In difference to SCM Article 6.3 (a), Article 6.4 “established that, in certain circumstances, a consideration of comparative market share alone will suffice to demonstrate that ‘*the effect of the subsidy*’ is to displace or impede exports.”[150] SCM Article 6.4 provides that a “‘Change in relative shares of the market’ shall include any of the following situations: (a) there is an increase in the market share of the subsidized product; (b) the market share of the subsidized product remains constant in circumstances in which, in the absence of the subsidy, it would have declined; (c) the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy.” Here, a WTO member could for example use the US market (and multiple others), in which Chinese products that benefit from the artificial exchange rate have either gained, held constant, should have otherwise lost, or lost, but at a lower pace, market share without

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[147] WTO, Indonesia – Certain Measures Affecting the Automobile Industry, Report of the Panel, (July 2, 1988), WT/DS64/R, para. 14.218, confirmed by WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1738.

[148] WTO, Indonesia – Certain Measures Affecting the Automobile Industry, Report of the Panel, (July 2, 1988), WT/DS64/R, para. 14.211, equally confirmed by WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1739.

[149] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1760.

[150] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1767.

the subsidy. Moreover, it would need to be shown that exports of the foreign like product were thereby displaced or impeded.

(c) Third Option – Showing significant Price Effects or Lost Sales

The third option under SCM Article 6.3 (c) concerns the possibility to find serious prejudice by showing negative price effects of that subsidy. In US-Upland Cotton the Appellate Body confirmed, based on a plain reading of Article 6.3(c) and the phrase 'in the same market' that "this phrase [in the same market] applies to all four situations covered in that provision, namely, 'significant price undercutting', 'significant price suppression, price depression [and] lost sales'."[151] It also shed light on the interpretation of 'significant' by stating that

> "Such significance may be manifest in a number of ways. The "significance" of any degree of price suppression may vary from case to case, depending upon the factual circumstances, and may not solely depend upon a given level of numeric significance.[...] Other considerations, including the nature of the "same market" and the product under consideration may also enter into such an assessment, as appropriate in a given case."[152]

Significant price undercutting is further specified under SCM Article 6.5, which stipulates that a member state needs to demonstrate price undercutting by

> "demonstrat[ing] through a comparison of prices of the subsidized [Chinese] product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values."

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[151] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1794.
[152] WTO, United States – Subsidies on Upland Cotton, Report of the Panel, (September 8, 2004), WT/DS267/R, para. 7.1329.

As another possible condition to establish ‘serious prejudice’ is to find a situation of ‘price suppression’ and ‘price depression’. According to the Panel in US-Upland Cotton ‘price suppression’ and ‘price depression’ are referring to

> “the situation where 'prices' [...] either are prevented or inhibited from rising (*i.e.*, they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been. Price depression refers to the situation where 'prices' are pressed down, or reduced."[153]

The third possible price effect is lost sales, on which the Panel in EC-Aircraft verified that “there is no legal basis in the text of the SCM Agreement for the view that lost sales must be demonstrated on the basis of price undercutting”[154]. Here, it is essential to show that potential lost sales as such were “important to the extent that they delay a manufacturer's ability to benefit from the important learning effects and economies of scale in this industry, and thus have a significance beyond their direct revenue effects.”[155] The Panel in EC-Aircraft seems argue that it has to be shown for example that through the subsidies the mere existence of Chinese products in a market was secured and led to losses in sales.[156] However, the Panel in EC-Aircraft was the first to deal with lost sales und it remains still rather unclear what besides price effects can trigger the loss in sales.

(d) Fourth Option – Showing an Increase in World Market Share

The fourth option is to show that “the effect of the [Chinese] subsidy is an increase in the world market share of [China] in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.”

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[153] WTO, United States – Subsidies on Upland Cotton, Report of the Panel, (September 8, 2004), WT/DS267/R, para. 7.1277.

[154] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1843.

[155] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1845.

[156] WTO, European Communities and Certain Member States - Measures Affecting Trade in Large Civil Aircraft, Report of the Panel, (June 30, 2010), WT/DS316/R, para. 7.1993.

c) Partial Conclusion

Provided that adverse effects were found, it remains quite unlikely that a Panel could be convinced that the benefiting industry is sufficiently specific.

5. Conclusion

In the present case it remains necessary to convince a Panel of a broad interpretation of financial contribution, which needs to be considered as an obstacle. Therefore, it seems rather difficult to be successful in front of a Panel.

VI. DEFENSIVE MEASURES

The second way to address the Chinese exchange rate policy of undervaluation is through defensive legal action. Unilateral trade remedies can be imposed as exception to the general trade liberalization through WTO law. This memorandum analyses the legal possibilities for WTO member states to impose countervailing duties and/or anti dumping duties. Within this study the discretion enshrined in the process of valuing customs is also considered as a defensive legal measure that will be explored as a possible way to react to the Chinese currency undervaluation. Engaging in defensive legal action is only able to lead to the protection of certain industries as trade remedies are applied to certain foreign products. Furthermore, more evidence is needed. Trade remedies require the showing of injury, which involves the duty to collect more evidence that taking account the economic sophistication involved might be difficult to get.

A. IMPOSING COUNTERVAILING DUTIES ARE LIKELY TO BE ILLEGAL UNDER WTO LAW DUE TO DIFFICULTIES IN FINDING A PROHIBITED OR ACTIONABLE SUBSIDY

Following a written application by or on behalf of an industry branch according to SCM Article 11.1 a WTO member may opt to open national investigations so as to impose unilateral countervailing duties under GATT Article VI:6 (a).

Both - challenging the alleged subsidy in front of a Panel and countervailing cuties - can be pursued simultaneously. Additionally, to find a prohibited or actionable subsidy a member needs to determine that the subsidy causes or threatens material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry according to GATT Article VI:6 (a).

1. Specific Subsidy

As stated above it is quite unlikely that a Panel would consider that a specific industry received a financial contribution as well as the construction of a benefit, which means that the finding of a specific subsidy in the sense of the SCM is rather improbable. As also stated above authors agree that it is very difficult to find specificity unless one follows the line of an export subsidy which is feasible to establish and it is according to SCM Article 2.3 presumed to be specific.

2. Injury

Furthermore, GATT Article VI:6 (a) requires a material injury to an established domestic industry in the same sense as for the elaboration on the actionable subsidy. Authors are quite doubtful that the injury requirement can be fulfilled.[157] First of all, according to Article 15 SCM the imposition of countervailing

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[157] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 36; Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 51.

duties requires that the injury that it causes to producers is quantified. It is not without reason that Staiger and Sykes call it a Herculean task considering the tough economic analysis involved.[158] However, it is assumed that the Chinese exchange rate policy takes away 25 % of the value of the RMB. Thereby, by exchanging USD for less RMB the Chinese authorities provide a subsidy in the same amount to the Chinese exporters, enabling them to offer products cheaper in foreign markets than an undistorted market would provide. Showing the following injury to domestic producers of other WTO members does not involve a higher effort than any other CVD injury analysis.

3. Causation

Moreover, GATT Article VI:6 (a) demands a causal link between the subsidy and the material injury. It has to be shown that the injury is caused by the subsidy. SCM Article 15.5 provides that "it must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement.

The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities." Additionally, also all other factors than subsidized imports that are causing injury and that must not attribute the injury caused by these imports must be examined to fulfill the so-called "non-attribution" requirement.[159] It is especially not enough to merely show that imports increased.[160]

Again, assuming that Chinese exporters possess a comparative advantage through receiving a subsidy showing causation should not amount to more difficulties than during any other CVD investigation.

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[158] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 36.

[159] The paragraph provides further that "[t]he authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, inter alia, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry."

[160] WTO, United States - Investigation of the International Trade Commission in Softwood Lumber From Canada, Report of the Panel (March 22, 2004), WT/DS277/R, para. 7.122.

4. Practical Considerations on Implementation

SCM Article 20 specifies that duties can only be introduced in the amount of the subsidy after the time, when the decision was taken to impose Countervailing Duties. When it comes to the duration of the duties SCM Article 21.1 as a general rule makes it possible to keep duties as long as and to the extend necessary to counteract subsidization, which is causing injury. However, Article 21.3 specifies that the initial period can only be longer than five years, if a substantiated request is made before the end of the timeframe indicating that the expiry would lead to a continuation or recurrence of subsidization and injury.

According to SCM Article 22 a WTO member state would need to publicly notice the determination leading to the duties. The new legislation would need to include provisions on judicial, arbitral or administrative tribunals or procedures for the purpose, inter alia, of the prompt review of administrative actions relating to final determinations and reviews of determinations within the meaning of Article 21. All parties are directly and individually affected by the administrative actions - e.g. the Chinese importers - would need to have access to review according to SCM Article 23.

5. Conclusion

The required financial contribution is a problem also for the unilateral imposition of a countervailing duty. If a financial contribution can be found/the Panel convinced of a broader interpretation of the term, it is feasible to establish a benefit and a contingency on exports. The specificity of an actionable subsidy is unlikely to be found regarding the exchange rate policy. The additional requirements for imposing CVDs do not pose more difficulties than in any other case.

B. ANTIDUMPING MEASURES ARE DEFENDABLE, ALTHOUGH THE OUTCOME OF A CHALLENGE ON THIS ISSUE IS VERY DIFFICULT TO FORESEE

1. Overview

When approaching exchange rate policies from an Antidumping perspective, one must keep in mind, as pointed out by Koops (2008), that at the time of negotiation of the Havana Charter, which lead to the creation of GATT, the category of "exchange dumping" – dumping based on manipulation of exchange rate – was identified, yet expressly discarded from the final version.[161] However, it must be pointed out that the prevailing Breton-Woods gold standard of the time meant that all currencies were in fact pegged. That makes the discussion of this modality of dumping more adjusted to the current reality.

Currently, two sets of rules provide for antidumping measures under WTO law, these being, respectively, GATT Article VI and the 1994 Antidumping Agreement. The former, although fairly brief, established three obligations which became the basis of the future antidumping regime: (i) the determination of dumping; (ii) the determination of injury; and (iii) causality.[162] The ADA, on the contrary is a much more detailed treaty, that seeks to harmonize existing national antidumping legislation and addresses the loopholes and lack of specificity of GATT Article VI.[163]

In the following paragraphs we shall direct our focus to the aspects through which the amount of devaluation in a currency could most effectively be inserted into the dumping margin by an investigating authority.

We shall consequently conclude our analysis by demonstrating that some of these measures could be imposed (namely the adjustment of the export price and currency conversion, under ADA Articles 2.4 and 2.4.1, respectively). However, it

[161] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 7.
[162] Yan Luo, "Anti-Dumping in the WTO, the EU and China - The Rise of Legalization in the Trade Regime and its Consequences" (2010), Kluwer Law International BV, The Netherlands, p. 61.
[163] Yan Luo, "Anti-Dumping in the WTO, the EU and China - The Rise of Legalization in the Trade Regime and its Consequences" (2010), Kluwer Law International BV, The Netherlands, pp. 70-71.

remains uncertain whether they would survive an eventual challenge before a WTO Panel.

2. Establishing Dumping

GATT Article VI:1 considers a product as being dumped, if it is "introduced into the commerce of another country at less than its normal value".[164] To characterize this situation one must demonstrate that a product's value in its country of origin – its "normal value" - is higher than that in the importing country – its "export price". The percentage difference between the two is the dumping margin against which antidumping duties will be calculated.

The key for levying antidumping duties *vis-à-vis* exchange rate devaluation is to take into account the misalignment when calculating the margin of dumping.[165] This implies, either to adjust the export price downward by the amount of the misalignment;[166] or to adjust the normal price upwards by the same amount.

3. Normal Value

ADA Article 2.1 defines normal value as the price of the product in the exporting country in the ordinary course of trade.

4. Non-Market Economies

Concerning the establishment of the normal value ADA Article 2.2 provides, the possibility to resort to the examination of the value in comparable third countries. In cases in which a substantial or complete monopoly of the importing state over trade creates difficulties in determining price comparability for the establishment of the normal value GATT Ad Article VI states that the use of the value in that country may not be appropriate.

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[164] Andrew Guzman and Joost Pauwelyn, "International Trade Law" (2009), Aspen Publishers, 1st ed., p. 434.

[165] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 52.

[166] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 615.

Therefore, in connection with ADA Article 2.7, which expressly refers to GATT Ad Article VI, the so-called non-market methodologies have emerged. They consist of calculating a normal value based on that of a third country. It is important to note that China, in its accession protocol, has specifically acquiesced[167] to being subject to this practice for a period of 15 years ending in 2016.[168] The United States, particularly, has made use of these methodologies by using prices in India as a basis for determining the normal value of Chinese products.

In this regard, it must be noted that some countries have concluded memoranda on China's status as a market economy. By means, for instance of a Memorandum of Understanding celebrated in 2004 by Brazil and China, the former unilaterally recognized China's status as a market economy.[169] This, in our view, does not correspond to a waiver of especially Brazil's prerogative to make use of non-market methodologies against that country, since the terms of Article 15(d) of China's Protocol of Accession indicate that for such recognition to be effective, it must be contemplated by the national law of the importing country[170]. This way, considering the fact that Brazil has never finalized the incorporation of the 1994 Memorandum of Understanding into its domestic law,[171] there is no impediment to its application of non-market methodologies against China. In the special case of Brazil the recognition of China as a market economy was never finalized. Therefore, this analysis requires a case-by-case determination.

Notwithstanding the apparent incongruence with precepts of general International Law on the inobservance of international commitments,[172] the Protocol of Accession is *lex specialis* to the relationship at hand and thus no valid recognition has been made.

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[167] China Accession Protocol to the WTO, §15(d), http://www.worldtradelaw.net/misc/ChinaAccessionProtocol.pdf (accessed 02 April 2011).

[168] Yan Luo, "Anti-Dumping in the WTO, the EU and China - The Rise of Legalization in the Trade Regime and its Consequences" (2010), Kluwer Law International BV, The Netherlands, pp. 338 – 339.

[169] Memorandum of Understanding between the Federative Republic of Brazil and The People's Republic of China on Cooperation on Matters of Trade and Investment, 12 November 2004, Article 1, http://www2.mre.gov.br/dai/b_chin_97_5380.htm (accessed 31 march, 2011).

[170] "15(d) - Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession."

[171] Marques Ciavolih and Claudia Maria Viana, "Comércio com a China: Análise Prática Recente de Defesa Comercial no Brasil", http://www.veirano.com.br/veirano/Home/Biblioteca/Artigos/tabid/47/ArtigoId/1001/Default.aspx, accessed (02 May, 2011).

[172] The Vienna Convention on the Law of Treaties, Article 27.

However, since non-market methodologies involve the construction of the normal value on the basis of a third economy and hence a third currency, its use would preclude the insertion of the currency misalignment into the dumping margin by the methods discussed below.

5. Calculating the Dumping Margin

a) Adjustment of Values

ADA Article 2.4 provides that "a fair comparison shall be made between the export price and the normal value". Its third sentence permits adjustments to "be made in each case, on its merits, for differences which affect price comparability, including differences in conditions and terms of sales, taxation, level of trade, quantities, physical characteristics, and <u>any other differences which are also demonstrated to affect price comparability</u>".

In order to exercise a fair comparison between the export price and the normal value, there might be the need to adjust the export price of a country by the amount of the exchange rate misalignment. This could be understood as a leveling of prices so as to establish a comparable benchmark between both currencies involved in a transaction.

In this sense the Panel in Argentina – Ceramic Floor Tiles found that Article 2.4 is an open ended provision, which allows for great discretion of the investigating authority for determining what measures affect price comparability.[173]

The Appellate Body reinforced this notion in United States – Hot Rolled Steel from Japan as follows:

> "We would also emphasize that, under Article 2.4, the obligation to ensure a "fair comparison" lies on the investigating authorities, and not the exporters. It is those authorities, which, as part of their investigation, are charged with comparing normal value and export price and determining whether there is dumping of imports.

[173] WTO, Argentina - Definitive Anti-Dumping Measures On Imports Of Ceramic Floor Tiles From Italy, Panel Report (September 28, 2001), WT/DS189/R 28, para. 6.113; Edwin Vermulst, "The WTO Anti-Dumping Agreement, A Commentary" (2005), Oxford University Press, Great Britain, p. 48.

However, it must be reinforced that, as of present date, no claim of exchange rate devaluation under ADA Article 2.4 has reached the WTO dispute settlement.

b) Currency Conversions

ADA Article 2.4.1, provides:

> "2.4.1 When 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, provided that when a sale of foreign currency on forward markets is directly linked to the export sale involved, the rate of exchange in the forward sale shall be used. Fluctuations in exchange rates shall be ignored and in an investigation the authorities shall allow exporters at least 60 days to have adjusted their export prices to reflect sustained movements in exchange rates during the period of investigation."

This article provides that an investigating authority may convert export prices (which are usually invoiced in US Dollars or Euros) back to the currency of the exporting country, in order to compare it with the normal value. Provided that the applicable rate of the conversion is that of the date of sale of the product, ADA Article 4.1.1 does not give any specific guidance as to the quantification of such rate, leaving this matter to the discretion of the authority.[174]

This reflects the negotiating history of ADA Article 4.1.1. As shown by Kim (2004), during the Uruguay Rounds, a proposal was made by Nordic countries to condition the calculation of the exchange rate to the *official exchange rate of the exporting country*. This proposal was not accepted since countries, among which the United States, reserved the right of using their own exchange rates for conversion purposes.[175]

[174] Edwin Vermulst, "The WTO Anti-Dumping Agreement, A Commentary" (2005), Oxford University Press, Great Britain, p. 49.

[175] Jong Bum Kim, "Currency Conversion in the Antidumping Agreement" (2004), Korea Institute for International Economy, www.eaber.org/intranet/documents/23/147/KIEP_Kim_00_4.pdf (accessed 25.05.2011), p 11.

Therefore, the resulting provision required only the use of the exchange rate on the date of the sale. In the absence of more detailed specifications, investigating authorities are freer in their use of exchange rate, provided that its use does not detract from providing a "fair comparison" as determined by ADA Article 4.1.[176]

It is worth noting, however, that the Panel in EC – Pipe Fittings found that the scope of application of currency conversion under Article 2.4.1 is limited to the comparison of (i) export prices; and (ii) the normal value, and thus could not be used to calculate either of them[177].

Thus, it would seem defendable for a national investigating authority to institute a policy based on ADA Article 2.4.1 that takes into account the amount by which a given currency is undervalued in defining the applicable exchange rate for conversion.

It is worth noting that when the prices being compared are invoiced in the same currency (ie.: dollar-dollar), the conversion is not allowed.[178] Therefore, in order to attribute an adjusted exchange rate, the invoices under scrutiny must necessarily be taken into account in different currencies (ie. dollar v. RMB), before any conversion is carried out.

Double conversions (dollar-RMB-Real) are not permitted.[179] However, one must consider that that most international trade is invoiced in US dollars, even when destined for countries that utilize a third currency. Although investigating authorities are indeed given considerable leeway in determining the rate of exchange applicable to the currency of the exporting country (which, in the present case is the RMB), the inability of translating the invoiced value into the currency of the importer might constitute less of an advantage, specially in cases where such currency is overvalued *vis-a-vis* the dollar, as it the case of the Real.

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[176] Jong Bum Kim, "Currency Conversion in the Antidumping Agreement" (2004), Korea Institute for International Economy, www.eaber.org/intranet/documents/23/147/KIEP_Kim_00_4.pdf (accessed 25.05.2011), p 12.
[177] WTO, European Communities - Anti-Dumping Duti Es On Malleable Cast Iron Tube Or Pipe Fittings From Brazil, Panel Report (March 22, 2003), WT/DS219/R, 7, paras. 7.981 – 7.982.
178 WTO, United States - Anti-Dumping Measures On Stainless Steel Plate In Coils And Stainless Steel Sheet And Strip, Panel Report (December 22, 2000), WT/DS179/R, paras. 6.11 – 6.112.
179 WTO, United States - Anti-Dumping Measures On Stainless Steel Plate In Coils And Stainless Steel Sheet And Strip, Panel Report (December 22, 2000), WT/DS179/R, paras. 6.11 – 6.112.

6. Determination of Injury

Determining injury under ADA Article 3 follows the same logic as under SCM Article 15. As discussed in pages 67 to 68 above, it would require a two-step analysis of (i) whether the industry of another WTO member state has suffered material injury by each or more of the non-exhaustive factors listed in ADA Article 3.4, which the Panels in *EC – Bed Linens* and *Mexico – Corn Syrup* confirmed necessary to be individually analyzed for determining injury;[180] and (ii) whether there exists a causal link between the dumped imports and the attributed injury, as referred to in further detail below.

Furthermore, in antidumping measures, literature considers that the very intricate economic nature of currency misalignment makes it very hard to establish a satisfactory demonstration of the requirement of "material injury" under ADA Article 3.[181] It is even suggested that such a determination could only be made in cases where undervalued imports cause a "complete breakdown" of an entire industry branch.[182] We beg to differ. ADA Article 3.1 requires only that an objective examination on the volume of dumped imports and on the impact of these imports on domestic products be carried out. In other words, the ADA requires only that injury be shown, for the duty will be imposed on the amount of the dumping margin, not of injury.

As an example, in the case of Brazil data shows that between 2006 and 2011 the amount of Brazilian companies that import Chinese commodities, final products and equipments jumped from 11% to 21%; 6% to 9%; and 5% to 8%, respectively.[183] Economists agree that an appreciable part of this is due to the misalignment between

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180 WTO, European Communities - Anti-Dumping Duties On Imports Of Cotton-Type Bed Linen From India, Panel Report (October 30, 2000), WT/DS141/R, 30, para. 6.154; WTO, mexico - anti-dumping investigation of high fructose corn syrup (hfcs) from the united states, Panel Report (February 27, 2000), WT/DS132/R/Corr, para. Mexico - Anti-Dumping Investigation Of High Fructose Corn Syrup (Hfcs) From The United States 7.128.

181 Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 51.

182 Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 51.

183 Cacau de Araújo, "CNI, Valorização Cambial é Principal Dificuldade na Concorrência com a China, Revista Exame, 03/02/2011, http://exame.abril.com.br/economia/brasil/noticias/cni-valorizacao-do-cambio-e-principal-dificuldade-na-concorrencia-com-a-china (Accessed 20/03/2011).

the Real and the RMB[184] Thus, in this example evidence of injury can indeed be produced without requiring a complete industry breakdown.

7. Threat of Material Injury

ADA Article 3.7 admits the consideration of injury that has not yet been caused, but that will in the foreseeable future occur due to change in situation caused by dumping. Threat of material injury is admissible under the conditions that it be (i) clearly foreseen; and (ii) imminent.

The footnote provides that threat of material injury would be occur, if there is a convincing reason to believe that there will be an increased importation of dumped products in the near future.

In the same line, the Panel, in US – Softwood Lumber considered that demonstrating the progression of circumstances that would create a situation in which injury would occur in the near future, "coupled with a predicted substantially increased imports, would result in an imminent change in circumstances such that injury would occur."[185]

This could play an important role for levying antidumping duties against a country that undervalues its currency, especially considering for example the case of the commercial relation between China and Brazil, in which exports from the latter have increased by around 230% between 2000 and 2009.[186]

8. Causal Link

ADA Article 3.5 requires that there must be a demonstration of causation between the dumped imports and the injury.[187] This demonstration must be based on

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[184] Cacau de Araújo, "CNI, Valorização Cambial é Principal Dificuldade na Concorrência com a China, Revista Exame, 03/02/2011, http://exame.abril.com.br/economia/brasil/noticias/cni-valorizacao-do-cambio-e-principal-dificuldade-na-concorrencia-com-a-china (Accessed 20/03/2011).

[185] WTO, United States – Investigation Of The International Trade Commission In Softwood Lumber From Canada, Panel Report (March 22, 2004), wT/DS277/R, 22, para. 7.60.

[186] It must be noted that Brazilian imports from China have shown a strong decline of 26% throughout 2009. 2010 figures are not available as of present date; "Total Brazilian Exchanges – China", The Brazilian Ministry of Development, Industry and International Trade, http://www.desenvolvimento.gov.br/sitio/interna/interna.php?area=5&menu=2033&refr=576 (accessed march 30, 2011).

[187] Andrew Guzman and Joost Pauwelyn, "International Trade Law" (2009), Aspen Publishers, 1st ed., p. 445.

an examination of any other "known factors", which cause injury to the domestic industry. The injuries caused by these other factors must not be attributed to the dumped imports.[188]

As the Appellate Body found in EC – Bed Linens, Article 3.5 requires "a demonstration that dumped imports are causing injury through the effects of dumping."[189]

It follows that the demonstration of causality for antidumping measure imposed in view of currency depreciation will comprise an economic analysis of all factors contributing the material injury.

9. Practical Considerations on Implementation

Furthermore, antidumping investigations can only proceed, if the margin of dumping is not insignificantly or if the volume of dumped imports is not negligible.[190] Further, members have to inform the WTO Committee on Antidumping practices about all findings on dumping actions, as well as to report on all investigations twice a year.[191] Finally, antidumping duties must expire after five years of their imposition, unless it can be shown that such expiration would lead to injury.

10. Conclusion

When considering antidumping standards to apply in cases of currency misalignment, it is key to transfer the amount by which a currency is undervalued into the margin of dumping in anti-dumping investigations.[192] For the purposes of

[188] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 91.

[189] WTO, European Communities - Anti-Dumping Duties On Imports Of Cotton-Type Bed Linen From India, Appellate Body Report (April 23, 2003), para. 112.

[190] WTO, "Antidumping, Subsidies, Safeguards: contingencies, etc.", http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm#top (Accessed 09/06/2011): "*Anti-dumping investigations are to end immediately in cases where the authorities determine that the margin of dumping is insignificantly small (defined as less than 2% of the export price of the product). Other conditions are also set. For example, the investigations also have to end if the volume of dumped imports is negligible (i.e. if the volume from one country is less than 3% of total imports of that product — although investigations can proceed if several countries, each supplying less than 3% of the imports, together account for 7% or more of total imports)*".

[191] WTO, "Antidumping, Subsidies, Safeguards: contingencies, etc.", http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm#top (Accessed 09/06/2011)

[192] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 52.

countervailing the impact of cheaper Chinese exports on industries of other WTO members, the misalignment could be incorporated into the dumping margin by (i) an adjustment of the export price on the basis of ADA Article 2.4; or (ii) by the conversion of the export price by the amount of the devaluation, under ADA Article 2.4.1.

Both solutions involve what is referred to as "the thorny problem of quantifying the misalignment resurfaces"[193]. However, for the present case, we work under the assumption that a misalignment exists and that it can be readily verified for each transaction considered in an antidumping investigation.

In analyzing both possibilities, one must take into account that under the ADA, antidumping measures are targeted at the individual producer, whereas exchange rate measures are part of a sovereign policy that affects the whole market.[194] If compensation for currency misalignment is adopted on an origin basis it is possible that a dumping margin will be attributed to a product that has not been dumped, which would amount to a violation of the ADA.[195]

It must also be mentioned that the use of non-market methodologies to calculate the normal value would prevent the use of price adjustment or currency conversion, since the normal value would be attributed in a third currency.

In conclusion, it is uncertain whether such duties, once imposed would resist a legal challenge, however, considering the unilateral nature of these measures and the considerable time that might elapse between the enactment of a duty, it being challenged before the WTO and the reaching of an award on its merits, such an initiative could be seen as a short term remedy to an emergency situation.

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[193] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 616.

[194] Catharina E. Koops, "Manipulating the WTO? - The Possibilities for Challenging undervalued Currencies under WTO rules", AMSTERDAM CENTER FOR INTERNATIONAL LAW 2010 RESEARCH PAPER SERIES, http://ssrn.com/abstract=1564093 (Accessed 19/03/2011), p. 7.

[195] Claus D. Zimmermann, "Currency Manipulation and the Paralysis of the Law", (August 31, 2010), http://ssrn.com/abstract=1300542 (Accessed 19/03/2011), p. 53.

C. THE VALUATIONS AGREEMENT CANNOT REMEDY AN UNDERVALUED RMB UNLESS A NEW RMB-TARGETED EXCHANGE RATE IS UNDERTAKEN, WHICH IS OF DUBIOUS LEGALITY

1. Overview

Customs authorities of importing countries are given some freedom to determine the conversion rate of foreign currencies to their home currencies for the purpose to assess the customs value of imports, subject to specific guidelines from the GATT. Specifically, two articles outline the limits of this freedom: GATT Article VII.4, and Customs Valuation Agreement (CV) Article 9 (also known as the "Agreement on Implementation of Article VII of the GATT 1994", Article 9). According to the General Interpretive Note to Annex A1 of the Marrakesh Agreement, the CV Agreement, concluded in 1994 as part of the Uruguay Round, prevails when a conflict arises between it and the original GATT Article VII.[196] However, no case has ever arisen to test either of these agreements for a conflict in any paragraph, including the paragraphs on currency conversion. Further, the cases that address the substantive obligations of the CV Agreement, namely the panel reports *Columbia – Ports of Entry* and *Thailand – Cigarettes* (both currently under appeal), do not address the CV articles on currency conversion, either.

As a result, these paragraphs remain very open to interpretation so far as is textually reasonable. While the CV Agreement's intent seems to prohibit WTO member states from re-calculating the value of goods denominated RMB to correct for the RMB's undervaluation, the Agreement does not prohibit states from forming a new RMB-targeted exchange rate to form the basis of future valuation of Chinese imports.

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[196] Sheri Rosenow and Brian O'Shea, *A Handbook on the Customs Valuation Agreement*, Cambridge University Press (2010), p. 25. The table of contents and first chapter can be accessed online at http://www.wto.org/english/res_e/publications_e/handbook_cusval_e.htm (accessed 4/4/2011).

2. The Intent of GATT Article VII and CV

To combat unfair trade practices, the single undertaking of the WTO already includes defensive mechanisms with specific procedural rules, such as the Agreement on Antidumping and Agreement on Subsidies and Countervailing Duties. As a result, the CV Agreement seeks to avoid overlap with the obligations and procedures of these defensive mechanisms. The CV preamble expresses this general intent, and also calls explicitly not to remedy dumping through customs valuation:

> *Recognizing* the need for a fair, uniform and neutral system for the valuation of goods for customs purposes that precludes the use of arbitrary or fictitious customs values;
>
> *Recognizing* that the basis for valuation of goods for customs purposes should, to the greatest extent possible, be the transaction value of the goods being valued
>
> …
>
> *Recognizing* that valuation procedures should not be used to combat dumping

Instead, the CV Agreement's general purpose is to determine the "transaction value" of imported goods, or the "price actually paid or payable for the goods when sold for export to the country of importation,"[197] adjusted for some slight modifications in Article 8. Consequently, with this focus on the "price actually paid" for goods, the CV Agreement is more focused on the proper accounting of imports as they were invoiced in fact, rather than correcting these invoices to combat specific trade practices. Hence, it is reasonable to construe that measures to combat subsidies should not be incorporated into CV calculations, just as measures to combat dumping are not. So, to the extent that the RMB's undervaluation subsidizes Chinese exports or raises the real dumping margin, these effects should be tackled exclusively in their appropriately named agreements and not the CV Agreement.

[197] This is the definition of "transaction value" in CV Article 1.

3. GATT Article VII:4 and CV Article 9.1

a) Calculating Customs Value

Similar to the goal to calculate the actual "transaction value" between exporter and importer, the CV paragraphs and older GATT Article VII:4 paragraphs addressing foreign currency conversion require states to value imports from China at the official public exchange rate. The source of these official exchange rates depends on whether one follows the rules of the older GATT Article VII:4 or the newer Customs Valuation Agreement, but both agreements aim to advance transparency and predictability.[198]

In GATT Article VII:4 (a), customs valuators are supposed to defer to the authority of the IMF, and the official exchange rates it posts, to calculate currency conversions.

> 4. (a) Except as otherwise provided for in this paragraph, where it is necessary for the purposes of paragraph 2 of this Article for a contracting party to convert into its own currency a price expressed in the currency of another country, the conversion rate of exchange to be used shall be based, for each currency involved, on the par value as established pursuant to the Articles of Agreement of the International Monetary Fund or on the rate of exchange recognized by the Fund, or on the par value established in accordance with a special exchange agreement entered into pursuant to Article XV of this Agreement.

"Par value" meant, at the time Article VII:4 was written, the official fixed exchange rates under the old Bretton Woods system. As a result of this reliance on par value, the exchange rate was predictable and transparent for calculating conversions. Further, GATT Article VII.4 explicitly rejects abusing the article as cover to enable members to raise their duties:

[198] Sheri Rosenow and Brian O'Shea, *A Handbook on the Customs Valuation Agreement*, Cambridge University Press (2010), p. 135.

d) Nothing in this paragraph shall be construed to require any contracting party to alter the method of converting currencies for customs purposes which is applicable in its territory on the date of this Agreement, if such alteration would have the effect of increasing generally the amounts of duty payable.

Hence, to the extent that GATT Article VII:4 still carries obligations on WTO member states, and these obligations have not been superseded by CV Article 9, no member state can retroactively implement a currency conversion formula to raise duties and counteract China's RMB undervaluation. Rather, any conversion rate a country uses on Chinese imports must have been public at the time of the transaction.

Although the Bretton Woods exchange regime has since given way to a regime largely of floating exchange rates, the requirement for exchange rates to be public and up-to-date still appears in CV Article 9. Here, instead of using the "par value" of the exchange rate as determined by the IMF, the importer must use "as effectively as possible" the "current value" of the exchange rate as determined by the "duly published competent authorities of the country of importation":

A. Where the conversion of currency is necessary for the determination of the customs value, the rate of exchange to be used shall be that duly published by the competent authorities of the country of importation concerned and shall reflect as effectively as possible, in respect of the period covered by each such document of publication, the current value of such currency in commercial transactions in terms of the currency of the country of importation.
B. The conversion rate to be used shall be that in effect at the time of exportation or the time of importation, as provided by each Member.

Interpreted very broadly, the phrase "shall reflect as effectively as possible…the current value of such currency in commercial transactions" opens the possibility for an importing country to redress through customs revaluation an exporting country's undervalued exchange rate. This interpretation hinges on the definitions of "effective" reflection and "current value." Specifically, if "current value" does not mean the published exchange rate that prevails between countries, but rather, means the exchange rate that *ought* to prevail between countries, then

potentially an importing country could use this "*ought*" exchange rate instead. In this interpretation, the obligation for importing countries to "reflect…current value" in currency conversion stands separately from that to use a rate of exchange "duly published by the competent authorities." Since rates of exchange should reflect the current value "as *effectively* as possible," arguably the only *effective* reflection of an undervalued currency is to adjust it upwards. So, importing countries are justified to adjust their currency conversions accordingly when determining customs value.

This very creative interpretation seems unlikely to comport with the intent and spirit of the Agreement on Customs Valuation. As stated earlier, the CV Agreement is meant to promote transparency and predictability. The old par value exchange rates of the IMF, and the current official exchange rates of government authorities, are transparent in the sense that they are openly available before a transaction occurs. As a consequence of this openness, importers and exporters can predict the value of their transaction accordingly. They need simply to look at the published exchange rate.

In contrast, an interpretation of "current value" that allowed members to impose their own formulae to adjust for currency undervaluation would undermine the transparency and predictability of the CV Agreement. No rules exist in the CV Agreement for revaluing currencies, meaning that importing members would have to devise their own rules; the resulting panoply of rules would not promote predictability, and the basis for each country's variation on the rules would be far from transparent. So, Article 9's obligation to "reflect…current value" should probably be read harmoniously with its obligation to use "duly published" exchange rates. The simplest way to reconcile these obligations is to merely define a currency's "current" value as the mathematical product of applying the "duly published" exchange rate. This interpretation also comports with the CV Agreement's intent not to use its provisions to remedy outside manipulation, such as dumping.

Thus, regardless of whether one applies GATT Article VII:4 or CV Article 9, WTO members do not seem at first to have a remedy available in the area of customs valuations against China's undervalued RMB. So long as for example Brazil's official exchange rate with China guarantees a certain number of real in exchange for RMB, these real should be converted at that official exchange rate when calculating the value of imports from China. This is in line with the CV Agreement's aim to approximate what importers actually pay for an import, rather than what they should pay for an import in a "fair" playing field.

b) Right to Implement a New RMB-Real Exchange Rate

Although the discussion above seems to discredit customs valuation as a tool for counteracting the RMB's undervaluation, the CV Agreement is remarkably open to the rights for importing countries that could enable WTO member states to use it as such a tool anyway. Consider CV Article 9.1, which states that the rate of exchange shall be determined by the "country of importation," rather than by the IMF as in GATT Article VII:4. Essentially, then, Brazil as an example for a WTO member state could post any exchange rate for transactions specifically between RMB and real, and hence through its own exchange rate undervaluation combat the RMB's undervaluation. Once the new RMB-to-real exchange rate became "current," even if it were designed purely as a trade remedy, Brazil's customs authorities would collect much higher customs valuations from Chinese goods in terms of real.

Nevertheless, such an RMB-targeted exchange rate poses legal problems of its own. Specifically, it raises the issue of "multiple currency practices," which are sometimes inconsistent with provisions of the GATT. Multiple currency practices occur when a government applies a favorable exchange rate to a product it wants to export, but a less favorable exchange rate to other products.[199] GATT Ad Article VI, for paragraphs 2 and 3, prohibits multiple currency practices that constitute a subsidy or form of dumping.

> 2. Multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 or can constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action by action under paragraph 2. By "multiple currency practices" is meant practices by governments or sanctioned by governments.

Earlier, this memorandum outlined the specific requirements to find a subsidy or dumping under the GATT Agreement, particularly under the SCM and ADA Annex I Agreements. In a new RMB-targeted exchange rate, a WTO member state

[199] Matthew R. Leviton, "Is it a Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO", THE BERKELEY ELECTRONIC PRESS, http://law.bepress.com/expresso/eps/660 (Accessed 25/05/2011), p. 9.

would have to avoid these requirements, so that it could not be subject to retaliatory countervailing duties or antidumping measures by China. As a result, to make an RMB-targeted exchange rate consistent with the GATT, a WTO member state's central bank should apply it across all countries and all products; effectively, it would be similar to setting an informal RMB peg, whose effects would redound to all its other exchange rates. If, by way of an informal peg, the GATT allowed China to undervalue its currency against the dollar, then by logical extension the GATT would have to allow a WTO member state to undervalue its currency against the RMB in the same way. Yet any WTO member state should only consider this option as a last resort, after all other WTO remedies have been exhausted. A WTO member's goal, after all, is not be to engage in competitive devaluations with China; it is to stop a round of competitive devaluations from occurring in the first place.

4. Conclusion

In short, GATT Article VII.4 and CV Article 9 strongly discredit the possibility to combat the RMB's undervaluation via merely re-calculating the currency conversion of Chinese imports in customs valuation. Nevertheless, since CV Article 9 has superseded GATT Article VII:4, and CV Article 9 allows a WTO member state to undertake any exchange rate it wishes; a state such as Brazil could still do this through the "back door" of setting a new, informal, sharply undervalued RMB-to-real exchange rate on all future imports. However, such a policy might just deepen the currency wars that Brazilian finance minister Mantega sought to avoid in the first place; the new exchange rate would essentially be a competitive devaluation. As a consequence, while legally possible under the CV Agreement, such an RMB-targeted exchange rate would probably not make sense from the point of view of most WTO member's stated policy objectives such as it is the case for Brazil.

D. IMPOSING SAFEGUARDS BASED ON CHINA'S PROTOCOL OF ACCESSION MIGHT BE A STRATEGIC SOLUTION

Although not directly related to currency devaluation, safeguards, as provided by the Agreement on Safeguards ("SA"), might be (and indeed have been) used as a targeted counterweight to some possible ramifications of monetary policy. To complete our analysis, we shall examine in the following paragraphs how such remedies could be applied on the basis of China's Protocol of Accession, by a country wishing to temporarily compensate damages caused by Chinese imported goods to specific domestic industries.

1. General Concept

Firstly it must be noted that safeguards, as provided by SA Article 2.1, consist of duties or other measures, imposed on an exceptional basis to a particular imported product, when such product is being imported in such increased quantities as to cause or threaten serious injury to a domestic industry.[200] Secondly, SA Article 2.1 provides that safeguards, as a trade remedy, should be imposed in a non-discriminatory fashion, thus applicable to all imports of the product in question, irrespective of the country that exports it.[201]

This requirement of non-discrimination would undermine the intent of countering the effect of an undervalued currency from a specific country, since safeguards, if imposed, should be so to all countries.

2. Accession Protocol

Notwithstanding the above, China, specifically, is still subject to the terms of its Protocol of Accession to the WTO, which provide for the possibility to withdraw concessions or otherwise to limit imports of Chinese products under Article 16 of the Protocol:

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[200] Andrew Guzman and Joost Pauwelyn, "International Trade Law" (2009), Aspen Publishers, 1st ed., p. 467.

[201] Andrew Guzman and Joost Pauwelyn, "International Trade Law" (2009), Aspen Publishers, 1st ed., p. 468.

> "1. In cases where products of Chinese origin are being imported into the territory of any WTO Member in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products… [3.] the WTO Member affected shall be free, in respect of such products, to withdraw concessions or otherwise to limit imports only to the extent necessary to prevent or remedy such market disruption."

This way, a WTO member suffering increased imports of certain Chinese products, which cause or threaten to cause disruptions to its domestic industries, is entitled to, unilaterally, increase its tariffs or quantitative restrictions *specifically against China*, so as to offset the injury caused.

Paragraph 1 of Article 16 of the Chinese Protocol of Accession, quoted above, conditions the imposition of safeguards to (i) increased quantities of imports; that (ii) cause or threaten to cause "market disruption". In this regard, paragraph 4 goes on to qualify "market disruption" as follows:

> "4. <u>Market disruption</u> shall exist whenever <u>imports</u> of an article, like or directly competitive with an article produced by the domestic industry, <u>are increasing rapidly</u>, <u>either absolutely or relatively</u>, so as to be a significant cause of material injury, or threat of material injury to the domestic industry. In determining if market disruption exists, the affected WTO Member shall consider objective factors, including the volume of imports, the effect of imports on prices for like or directly competitive articles, and the effect of such imports on the domestic industry producing like or directly competitive products." [*our emphasis*]

The recent Panel in US – Tyres, in analyzing the scope of Article 16.4, provided the following clarification of the on what would constitute a market disruption:

> "Accordingly, in order for imports to be "increasing rapidly", they need only be increasing "with great speed", or "swiftly". There is no need for

any swift progression in the rate of increase in those imports. Nor does a decline in the rate of increase necessarily preclude a finding that imports are "increasing rapidly". Under the Protocol the rapid increase need only be on an absolute or relative basis."[202]

This precedent therefore indicates that "market disruptions" susceptible of giving cause to a safeguard against Chinese products must result from a rapid increase of imports either on a relative basis (as by comparing the relative rate of increase of one period to the next) or on an absolute basis (as by comparing the total increase in the number of imports between two periods, even if the relative rate of growth has shrunk), granted only that importation does indeed intensify.

3. Temporary Scope of Application

The Chinese Protocol of Accession prohibits the application of the temporary safeguard mechanism beyond November 10, 2013. Article 16, paragraph 9 of the Protocol reads:

> "9. Application of this *Section* shall be terminated 12 years after the date of accession."[our emphasis]

One must note, however, that the discontinuation of the application of the section that provides for temporary safeguards does not compel the termination of measures that are already in force by that date. Paragraph 6 of Article 16 provides:

> "6. A WTO Member shall apply a *measure pursuant to this Section* only for such period of time as may be necessary to prevent or remedy the market disruption." [our emphasis]

The Protocol clearly differentiates between the applicability of "sections" and of "measures pursuant to a section". Whereas it is evident that a 'measure pursuant to a section' cannot be levied if the underlying 'section' is not applicable, nothing in the

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[202] WTO United States – Measures Affecting Imports Of Certain Passenger Vehicle And Light Truck Tyres From China, Panel Report (December 13, 2010), WT/DS399/R, para. 7.92.

Protocol indicates that the suspension of the application of the section itself would entail the termination of those measures that are already in place.

Furthermore, the term "application" is defined by the Oxford English Dictionary as "the action of putting something into operation".[203] In this sense, the limitation contained within paragraph 9 clearly only relates to new measures that have not yet been put into operation, thus excluding from termination any measures already in force by the date of termination.

Finally, it must be noted that Article 16, paragraph 7 of the Chinese Protocol of accession limits the duration of temporary safeguard measures to a maximum of 200 days. Therefore, considering the above, Chinese products would only be subject to such measures until no later than 29 May, 2014.

4. Conclusion

This way, the imposition of safeguards based on China's Protocol of Accession could prove strategic for a state such as for example Brazil, whose manufacturing industries have suffered a significant loss due to the inflow of cheap Chinese products, which benefit from an undervalued exchange rate. The great differential of this remedy, as opposed to antidumping or countervailing duties, is that it is not conditioned by the determination of any illicit conduct by the exporter. This relieves the affected country from the burden of proving the monetary misalignment, being required only to demonstrate an increase in exports and its consequent injury to domestic economy.

[203] Oxford Dictionaries Online, http://oxforddictionaries.com/. Accessed 9/6/2011.

VII. IMPACT ANALYSIS

This sections aims at providing a brief outlook on the impacts and reactions that might follow the institution of offensive or defensive measures under WTO Law discussed in this memorandum.

A. OFFENSIVE ACTIONS

If successful, all of the offensive actions above would share a similar impact, and indeed, it is the impact that many WTO members seek most: the Panel/AB would require China to revalue RMB. This would be the best-case-scenario outcome because, if China brought the RMB into conformity through revaluation, such revaluation would remove both the tariff and subsidy effects of undervaluation specified in the beginning of the memorandum. As a result, RMB revaluation would both increase market access for foreign goods in China, and simultaneously, limit the market access of Chinese goods in other WTO member countries. Defensive measures, in contrast, do not offer the possibility of such a best-case-scenario outcome, because they can only counterbalance the subsidy and not the tariff effect (see below).

Further, even if China considered RMB undervaluation too sensitive an issue to conform to a Panel/AB ruling, winning on an offensive action would still enable the complaining country eventually to retaliate after all other channels had been exhausted. While retaliation would not counter the tariff effect of China's currency undervaluation, the retaliation would counter the subsidy effect. As a result, WTO-approved retaliation would offer a similar economic remedy as the defensive actions below. However, unlike the defensive actions, retaliation requires much more time for approval. So, if a country desperately needed to shut out Chinese imports, defensive actions would better meet this time sensitivity.

Nevertheless, the large amount of time involved in an offensive action is not necessarily a negative attribute, if the long term objective is to get China to revalue and the WTO member is willing to endure subsidized Chinese goods in the meantime. Indeed, a lengthy offensive case in the WTO could offer ongoing political leverage

against China on its currency practice, without backing China into a corner in the way that defensive measures might. If China is sufficiently risk-averse and worried that it would lose this WTO case, China could revalue to preempt the case's conclusion. Indeed, the U.S. experience thus far with China—where the threat of calling China a currency manipulator in June 2010, with concordant tariffs, prompted mild Chinese revaluation at the last minute—suggests that China might be so risk averse. An offensive WTO case could amplify this last-minute-revaluation dynamic, and further, add leverage to G-20 negotiations on the issue.

B. DEFENSIVE ACTIONS

1. Countervailing Measures

Even if CVD investigations were successful, a WTO member could impose duties on certain imported Chinese products in the amount of the subsidy only. Therefore, CVDs would protect solely certain domestic industry sectors and not increase the market access of exporters to China. For the initial period after imposing duties the access could even be worse due to Chinese retaliation against importers of the specific WTO member country. Furthermore, Chinese importers would be able to challenge the duties in front of the judicial review mechanism that would need to be introduced by legislation according to SCM Article 23. Moreover, the Chinese government could respond by challenging the legality of the duties within the WTO dispute settlement system in consistence with SCM Article 30.

2. Antidumping

Antidumping duties have been the preferred remedy for countering some of the effects of cheaper Chinese imports into the domestic market. If such measures are applied taking into consideration the possibilities presented in the present memorandum, namely (i) adjustment of values; or (ii) currency conversion, one must consider, it is very likely that China will file a retaliatory claim seeking to establish the illegality of such actions. Since such a dispute would be novel within the DSB, it could end up providing some valuable standards that, presently, do not exist.

Furthermore, these measures could prompt China to install retaliatory antidumping duties of its own, unilaterally.[204] This, however, could be challenged, supposing that, given their retaliatory nature, such measures would not sufficiently meet all the necessary standards for the imposition of antidumping duties.

3. Customs Valuation Agreement

Revaluing Chinese imports upwards to account for their currency undervaluation would offer some small short term gains, but possibly with damaging long term costs. Specifically, revaluing Chinese imports has the benefit of immediate effect, and since China does not have to be noticed beforehand, a WTO member could use this tactic as a surprise. Further, customs revaluation could be applied against *all* goods invoiced in RMB, converted upward with a simple formula to account for the extent of the undervaluation. Undoubtedly, however, such a move would provoke Chinese litigation against the customs revaluating member state under at *least* CV Article 9.1 and possibly GATT Article VIII:4. As discussed above, the member state would probably lose under these articles, because they do not give much scope for actions taken as trade remedies. So, any member state should hesitate before using the CV Agreement to revalue Chinese imports. Such revaluation would probably only be effective for the time of litigation, and after the losing the case, a WTO member would not be able to use this tactic again.

Informally pegging the domestic currency to the RMB would avoid the problem of Chinese litigation, but may result in other, more damaging economic impacts. Figuratively speaking, it is leaping out of the frying pan and into the fire. Indeed, such a peg would probably escalate the currency war, which many policymakers have stated explicitly they wish to avoid.

[204] Art. 56 of China's 1997 Antidumping law reads: "*Where any country (region) takes discriminative anti-dumping measures on the products exported from the People's Republic of China, the People's Republic of China may, upon the actual circumstances, take corresponding measures against the country (region).*" The clearly retaliatory language of this provision indicates a possible inclination to the imposition counter-measures. This would seem even more likely if the action at hand was aimed at its monetary policy in the first place.

4. Safeguards

The imposition of safeguards on the basis of Article 16 of China's Protocol of Accession is by far the safest way of levying defensive measures aimed at countering the effects of currency misalignment, since there is already case law on the issue (US-Tyres) that considers its legality. This precedent provides an important degree of predictability which does not exist with the other defensive measures discussed above.

The biggest limitation to application of such measures is a temporal one, since, as discussed in further detail above, they may only be applied until November 10, 2013. This deadline, however, does not limit the implementation of on-going measures, which can be carried normally for their maximum term of 200 days.

VIII. CONCLUSION

In accessing the legality of China's fixed exchange rate policy, and the viability of challenge to such measures before the WTO Dispute Settlement Body, we arrive at the following conclusion regarding the specific questions that were posed by the client:

1. Under what legal basis could a claim against a country practicing exchange rate devaluation be argued within the WTO Dispute Settlement Body?

A WTO member could bring a claim against China before the WTO Dispute Settlement Body with regard to its policy of exchange rate undervaluation inasmuch it falls under the standards of "measure" in GATT Article XXIII or "exchange action" in Article XV:4. This memorandum argues that "measure" under Article XXIII has a broader meaning than "exchange action" under Article XV:4, thus, even if the requirement of the latter is not met, China's policy still falls within the scope of Article XXIII, under which this paper finds a nullification or impairment of legitimate expectations of benefit for exporters to China. Through massively acquiring and holding US securities the currency peg is endowed with an undervaluation of the RMB.

However, in case of GATT Article XV a breach of these provisions is dependent upon the "frustration of the intent" of another substantive GATT measure. As we have approached above, it is unclear whether currency devaluation violates GATT Article II or whether it could relate to a *de facto* subsidy under GATT Article VI. As a financial contribution for domestic industries in China under the SCM agreement is difficult to construe, the Chinese exchange rate policy might not represent a subsidy. If, however, a Panel follows a broader understanding of the term, there are good arguments for an export subsidy. This is not the case with regard to an actionable subsidy.

2. Which trade remedies could a developing country impose against a WTO member that practices exchange rate devaluation?

This memorandum finds that levying countervailing duties in view of an exchange rate undervaluation policy is likely to be illegal under the SCM. However, this only the case because of doubts concerning the existence of a subsidy and not regarding the additional CVD specific conditions that are likely to be fulfilled. Contrarily, the imposition of antidumping duties seems to be justifiable for a number of arguments, all of which have foreseeable counterpoints in the event of a challenge. However, the novelty of introducing currency misalignment into the calculation of this remedy makes the outcome of litigation on this matter difficult to foresee. Nevertheless, as has been pointed out, considering the unilateral character of antidumping duties and the amount of time that would elapse between the imposition of the remedy and reaching a final award in the WTO, such a measure might be considered as a short-term remedy to an emergency situation.

Indeed, the very viability of antidumping duties negates in part the viability of the Customs Valuation Agreement for raising the price of imported Chinese products. Specifically, the CV Agreement warns against using customs valuation to correct antidumping practices, so if a WTO member corrects for currency undervaluation in the dumping margin, it would be inconsistent to do so also in normal customs valuation. Overall, the CV Agreement is not meant to combat manipulative trade practices. In addition, the currency conversion provisions of the CV on their own do not offer a very strong case for countering undervaluation, given their emphasis on published exchange rates.

We further note that China's protocol of Accession to the WTO allows for members to impose safeguard duties specifically against Chinese imported products that cause injury to the domestic industry of the importing country. On this note, we argue that these safeguards might present a viable reaction to some of the effects of a devaluated currency, because it avoids discussing currency devaluation altogether. However, all safeguards are only temporary measures.

3. Which form of legal action would be more effective against a WTO member that practices exchange rate devaluation?

In conclusion, we find that challenging an exchange-rate devaluation on the basis of GATT Articles XV and XXIII would represent an opportunity for the WTO Dispute Settlement Body to provide a much needed authoritative interpretation as to the legality of currency misalignment under international trade law. However this would constitute a direct intervention in members' internal monetary policy, for which the WTO was never conceived, possibly creating considerable tension that would dangerously stress the legitimacy trade system.[205] Moreover, potential distortions of bilateral relations between the two countries should be added to the Notwithstanding, we do envisage the possibility that such a challenge be upheld in litigation, which makes the route of taking an offensive action possibly more effective than imposing trade remedies, which would require extensive investigations for each and every imported product separately.

Finally, it must be noted that, given the importance of China's monetary policy to its long-standing goal of economic development, even in the event that the devaluation of the RMB is found to be in breach of WTO law, it is very unlikely that it will ever comply. Therefore, enforcement of an award will most likely take place through retaliation by the winning party. This raises the concern that a series of retaliations by different countries would indeed open the "Pandora's box for political strife and tension" Staiger and Sykes foresee[206], that could very well undermine the whole system.

[205] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 608.

[206] Robert Staiger and Alan Sykes, "'Currency Manipulation' and World Trade", Working Paper 14600 (2008), National Bureau of Economic Research, http://www.nber.org/papers/w14600 (Accessed 20/03/2011), p. 608.

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