Don Yuan: China's "Selfish" Exchange Rate Policy and International Economic Law

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Introduction

If there is any single character in the history of literature that stands for egoism and selfishness, it is certainly the one of Don Juan, the restless and insatiable lover and seducer of women. If there is any trading nation that is perceived — at least in the United States — to be similarly selfish and insatiable in its conduct of foreign economic relations, it is certainly China, whose currency unit is the yuan, also called renminbi (The People's Money).[1] Given the permanent accusations that are being raised against China for its exchange rate regime for the yuan, one feels inclined to speak of China as the Don Yuan of our times. However, we should be careful with excessively quick answers to a matter that is far more complicated in reality.

Whether the yuan is undervalued or not (and if yes, whether the Chinese exchange rate policy is a breach of the rules of public international law) is of course not a question of romantic literature, but of tough international economic politics, and it is a matter of substantial "monetary power".[2] Political commentators regularly point to the possibility that China could "pull the plug" on the American economy, write off its US dollar reserves and cause the dollar to crash by putting the dollar share of its foreign reserves of about 2 trillion US dollar, approximately 650 billion US dollar in treasury bonds,[3] on the market. The language used in this

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[1] The name of the currency as a whole is Renminbi, the greatest currency unit is the yuan, divided into 10 jiao or 100 fen. The international abbreviation is CNY, the Chinese one is RMB.

[2] Cf. Kirshner, *Currency and Coercion – The Political Economy of International Monetary Power*, 1995, pp. 3 et seq. on the concept of "monetary power".

[3] As of December 2008.

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context is of particular harshness and has a surprisingly military tone: exchange rates are described as “weapons”[4] in a “currency war”,[5] the aforementioned possible dollar sales named the “nuclear option”.[6] Generally, the international economic relations of our times are branded as a “world war for welfare”,[7] nations like China perceived as “aggressors”.[8] Some authors even see the economic policy disputes between the USA and China as a mere forerunner to a military conflict in the future.[9] We should all hope that things will turn out a lot better at the end of the day, but — against this backdrop — we should take the underlying legal questions all the more seriously.

This paper will deal with the question whether the exchange rate regime operated by the People’s Republic of China is contrary to the rules of International Economic Law, or whether it is merely a — maybe selfish but absolutely lawful — way for the Chinese government to pursue an economic policy it deems appropriate for its country for the time being. The questions dealt with in this contribution are, however, not limited to the case of China. Other countries have been accused of exchange rate manipulation as well. In the immediate past, the recent economic downturn caused increased concerns about competitive currency devaluations taking place.

The Chinese Exchange Rate Regime

Until 1978, China applied a strict policy of foreign exchange restrictions and controls as part of the centrally planned economy. Since then, the system was gradually transformed and a dual exchange rate system applied, with a fixed and a market rate existing side-by-side. In 1994, China abolished the dual system and began to formally operate a managed floating, which was in fact a strict peg against the US dollar. Between 1995 and July 2005, China fixed the external value of the yuan against the US dollar at an exchange rate of 8.28 yuan to 1 US dollar. In July 2005 China finally ended the peg, up evaluated the yuan by 2.1% against the dollar

[4] Henning, The Exchange Rate Weapon, Macroeconomic Conflict and Shifting Structure of the Global Economy, EUI RSCAS Working Paper No. 2005/11.

[5] Posen, Avoiding a Currency War, The International Economy (Summer 2004), p. 10.

[6] See, for example, Evans-Pritchard, China threatens “nuclear option” of dollar sales, http://www.telegraph.co.uk, 10 August 2007.

[7] Steingart, *Weltkrieg um Wohlstand*, 2007.

[8] Hirn, *Angriff aus Asien: Wie uns die neuen Wirtschaftsmächte überholen*, 2008.

[9] Susbielle, Chine–USA: La guerre programmée, 2006.

and began a gradual managed evaluation, with continued heavy interventions by the People's Bank of China.[10] The descriptions for this kind of policy extend from a "crawling peg" to a "managed float plus". At the end of 2008, the yuan's dollar value had increased by roughly 20%, with the yuan trading at 6.83 against 1 US dollar. At the same time, with a bilateral monthly trade surplus of 17.5 billion US dollar (September 2008) in its trading relations with the United States, China accumulated foreign reserves of 1.9 trillion US dollar (estimate, October 2008), equating to almost 20% of the United States' public debt. In order to avoid the possible negative domestic effects of the foreign exchange interventions, which go hand-in-hand with a significant increase of the amount of money in circulation and a corresponding inflation threat, China has made huge and largely successful efforts to sterilize the interventions.

From the perspective of exchange rate theory, it is obvious that the yuan is manifestly undervalued. Without the interventions of the People's Bank of China, the massive capital inflow and the record trade surplus could not persist at the same time, neither theoretically nor practically. A floating exchange rate would appreciate until the point where the balance of payments would be equalized, with the current account balance and the capital and financial account balance outweighing each other. However, this would not necessarily mean a decrease in the trade surplus with the USA. With the export price of goods increasing as a consequence of an exchange rate appreciation, the import price of imported raw materials and semi-processed goods would fall, partially outbalancing the price-increasing effect.

International Reactions to China's Exchange Rate Policy

The view that the yuan is manifestly undervalued is shared almost globally. Discussions about the topic have been on the agenda of international economic institutions for several years now. Not only the United States, but also the G7, the

[10]For a more detailed account of China's exchange-rate policy, see Goldstein, Renminbi Controversies, Cato Journal (2006) 2, p. 251; Goldstein/Lardy (eds.), *Debating China's Exchange Rate Policy*, 2008; Griswold, Who's Manipulating Whom? China's Currency and the U.S. Economy, Cato Institute Trade Briefing Paper No. 23, 11 July 2006; Hale/Hale, Reconsidering Revaluation — The Wrong Approach to the US–Chinese Trade Imbalance, Foreign Affairs (2008) 1, p. 57; Herr, Das chinesische Wechselkurssystem, ApuZ 7/2008, p. 27; Hilpert, Transpazifische Währungskonflikte, SWP-Aktuell 41 (October 2003); Keidel, China's Currency: Not the Problem, Carnegie Endowment for International Peace Policy Brief 39 (June 2005); Lardy, Exchange Rate and Monetary Policy in China, Cato Journal (2005) 1, p. 41; Ogawa, The Chinese Yuan after the Chinese Exchange Rate System Reform, RIETI Discussion Paper Series; 06-E-019 U.S. Department of the Treasury Office of International Affairs, Report to Congress on International Economic and Exchange Rate Policies, December 2008, pp. 16 et seq.; Hartquist/Beckington/Collis, China's Policy of Substantially Undervaluing the Renminbi: A Challenge for the International Monetary and Trading System, Research Paper Prepared by the Trade Law Advisory Group, 15 September 2008, p. 43 et seq.

IMF and the European Union have repeatedly demanded a more flexible and quicker appreciation of the yuan. The G8 Summit 2007 in Heiligendamm, in its Declaration on "Growth and Responsibility in the World Economy", stressed the importance of real exchange rate flexibility for the necessary reduction of global imbalances. The European Union, in its Communication "EU — China: Closer partners, growing responsibilities" describes "[i]ncreasing exchange rate flexibility [as] an important factor, helping rebalance growth towards domestic demand and increasing Chinese households' purchasing power".[11] In a document entitled "EU–China Trade and Investment — Competition and Partnership", the formulations are similar, but more focused on the European Union's interest in the matter: "China's exports to the EU have also benefited from the currency alignment of the Chinese renminbi to the dollar, which has given them an important competitive advantage. China is now moving towards increased flexibility in its currency regime, which should help shift the balance to higher levels of domestic consumption".[12] Consequentially, the European Union has in recent times increased the pressure on China to let the yuan rise more quickly. Similarly, the IMF in its Report for the 2006 Article IV consultations noted that "movement in the renminbi's real value over a considerable period of time has not been in line with most fundamental factors that are generally considered to be important in determining the exchange rate's real value" and that "all of these developments point to the currency as being undervalued and that this undervaluation has increased further since last year's Article IV consultation".[13] In February 2008, the Managing Director of the IMF, Dominique Strauss-Kahn, at the conclusion of his visit to China stated: "On exchange rate policy, we welcome the authorities' objective of allowing greater flexibility over time. However, we encourage a faster pace of appreciation that would be helpful for addressing China's key economic challenges and would also contribute to preserving global economic stability".[14]

The highest political pressure has, however, been exercised by the United States. China's exchange rate policy has been subject of bilateral discussions between the USA and Chinese Governments in different fora, among them the US–China Joint Committee on Commerce and Trade (JCCT), the US–China Joint Economic Committee (JEC) and the US–China Strategic Economic Dialogue (SED). However, China, since having abolished the dual exchange rate regime in 1995, has never been designated as a "currency manipulator" under the Exchange Rates and International Economic Cooperation Act of 1988,[15] even though such a finding would only impose an obligation on the US Secretary of the Treasury "to take action to

[11]COM(2006) 631 final, p. 6.

[12]European Commission, Directorate General External Trade, Global Europe. EU–China Trade and Investment — Competition and Partnership, p. 8, available at http://trade.ec.europa.eu.

[13]IMF Country Report No. 06/394, p. 17, para. 24.

[14]Statement by IMF Managing Director Dominique Strauss-Kahn at the Conclusion of his Visit to China, IMF Press Release No. 08/26, 15 February 2008.

[15]The Exchange Rates and International Economic Policy Coordination Act of 1988 was passed as Title III, Subtitle A of the Omnibus Trade and Competitiveness Act of 1988.

initiate negotiations with such foreign countries" (Sect. 3004 (b)).[16] However, the pressure on China might well increase under the Obama presidency. The then presidential candidate Barack Obama, in a letter to the President of the United States National Council of Textile Organizations, dated 24 October 2008 wrote:

> A fair trading system requires fairness in each country's foreign exchange practices. The massive current account surpluses accumulated by China are directly related to its manipulation of its currency's value. The result is a large imbalance that is not good for the United States, not good for the global economy, and likely to create problems in China itself. China must change its policies, including its foreign exchange policies, so that it relies less on exports and more on domestic demand for its growth. That is why I have said that I will use all diplomatic means at my disposal to induce China to make these changes.

Barack Obama was also a co-sponsor of the "Currency Exchange Rate Oversight Reform Act" as well as the "Fair Currency Act" to which we will get back shortly. In January 2009, the new US Treasury Secretary, Timothy Geithner, explicitly accused China of manipulating its currency and suggested a more confrontational stance towards China.[17] On the other hand, in times of the global financial crisis, the USA is increasingly dependent on the continuous purchase of Treasury Bonds by the Bank of China, which naturally limits the capability of imposing pressure significantly. Furthermore, there seems to remain some scepticism within the new US administration about the right strategy to address the matter. In his hearing before the United States Senate's Committee on Finance, the then USTR nominee Ronald Kirk answered practically all questions regarding China's exchange rate policy identically with very careful wording:

> I appreciate the concerns that you have raised about China's currency practices. The Treasury Department is responsible for issues pertaining to other countries' currency practices, and will make its determination concerning China's currency in its semi-annual report to Congress on international economic and exchange rate policies. If confirmed, I will work closely with the other senior officials in the Administration to develop a comprehensive and integrated policy to address the full range of China's trade policies that impact the United States. As part of this comprehensive effort, of course, we will need to review China's actions for consistency with its WTO obligations. I will aggressively pursue WTO action whenever that approach will be the most effective and appropriate means to address U.S. concerns.[18]

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[16]On this topic, see Henning, *Accountability and Oversight of US Exchange Rate Policy*, 2008, pp. 17 et seq.

[17]See Calmes, Geithner hints at harder line on China, International Herald Tribune 23 (January 2009).

[18]See United States Senate Committee on Finance, Hearing on Confirmation of Mr. Ronald Kirk to be United States Trade Representative, 9 March 2009, pp. 45, 61, 62, and 109, available at http://finance.senate.gov/hearings/testimony/2009test/031109QFRs%20for%20SubmissionRK.pdf.

Administrative and Legislative Initiatives in the United States

Whereas governmental reactions to China's exchange rate policy have remained diplomatic in character, a broad coalition of political forces in the United States since 2003 has initiated several administrative and legislative initiatives against the Chinese policy. They all share the view that China's policy is a breach of provisions of the IMF Articles of Agreement and/or provisions of WTO Agreements. However, they propose different courses of action. In the present contribution, we will restrict our considerations to the most important proposals.[19]

The Section 301 Petitions

A course of action taken against the Chinese exchange-rate regime on the basis of existing US trade laws consisted of three petitions for relief under Section 301 of the Trade Act 1974 which were filed by the "China Currency Coalition" or similar flags under which supporters of trade measures against the Chinese exchange rate regime were sailing, in 2004, 2005 and 2007. Section 301 provides for a procedure under which the USTR can take retaliatory action against foreign trade practices deemed "unfair" by the US administration.[20] All three petitions were dismissed by the USTR within the 45-day period provided for. The last petition of 17 May 2007[21] had been supported by 42 members of Congress (the "Bipartisan China Currency Coalition"), and called upon the USTR to request consultations with China under the WTO Dispute Settlement Understanding, claiming that acts, policies, and practices of the government of China had resulted in a significant undervaluation of China's currency, and that the undervaluation amounted to: (1) a prohibited export subsidy under the Agreement on Subsidies and Countervailing Measures and Articles VI and XVI of the GATT 1994, (2) exchange action under Article XV of the GATT 1994 that frustrated the intent of articles I, II, III, VI, XI, and XVI of the GATT 1994, and (3) subsidies that were inconsistent with China's obligations under Articles 3, 9, and 10 of the Agreement on Agriculture. The petition also alleged that these acts, policies, and practices of China violated rights of the United States under Articles IV and VIII of the IMF Statute. The USTR rejected the initiation of an investigation, "because, among other reasons, an investigation would not be effective in addressing the acts, policies, and practices covered in

[19]For an overview of the policy options see Morrison/Labonte, China's Currency: Economic Issues and Options for U.S. Trade Policy, CRS Report for Congress RL 32165, updated 9 January 2008.

[20]For a description and account of Section 301, see Jackson/Davey/Sykes, International Economic Relations, (4th Ed.) 2002, pp. 332 et seq.

[21]Available at http://waysandmeans.house.gov/media/pdf/110/currencypetition.pdf.

the petition".[22] The earlier petitions had been rejected using similar language. Like the Exchange Rates and International Economic Policy Coordination Act of 1988, Section 301 grants significant administrative discretion to the responsible authorities. Most of the legislative initiatives with regard to the "currency problem" can be understood as an effort of the legislature to reduce this discretion and force the administration into action. None of these initiatives has been successful up to early 2009.

The Schumer–Graham Bill of 2003

The first and certainly most prominent legislative initiative was taken by Senators Charles Schumer and Lindsey Graham. In September 2003, they proposed a bill (the so called "Schumer–Graham Bill")[23] which found the Chinese currency to be pegged against the US dollar at an artificially low level, effectively resulting in a significant subsidization of exports and a virtual tariff on imports. The undervalued Chinese currency and the Chinese Government's intervention — in the words of the draft bill — "violate[d] the spirit and the letter of the world trading system" (Sec. 1). In reaction, the draft bill imposed an additional ad valorem duty of 27.5% on "any article that is the growth, product, or manufacture of the People's Republic of China, imported directly or indirectly into the United States" (Sec. 2 (a)) for as long as China did not appreciate its currency to market levels. As a justification, the Schumer–Graham Bill referred to Art. XXI GATT, the national security exception of the GATT, which is of course not designed for situations of exchange-rate manipulation, even if such manipulation did in fact exist.[24] In later congressional sessions, similar versions of the draft bill were reintroduced.

The Ryan–Hunter Bill

A number of legislative initiatives[25] during the 109th and 110th Congress were directed at an amendment to the Exchange Rates and International Economic Cooperation Act 1988. In essence, they redefined the circumstances under which

[22]See USTR, Trade Policy Agenda and 2007 Annual Report, p. 206 et seq., available at http://www.ustr.gov/Document_Library/Reports_Publications/2008/2008_Trade_Policy_Agenda/Section_Index.html, last accessed on 3 March 2009); see also Federal Register, Vol. 72, No. 161, p. 46688.

[23]S. 1586 [108th], A Bill to authorize appropriate action if the negotiations with the People's Republic of China regarding China's undervalued currency and currency manipulation are not successful.

[24]Denters, Manipulation of Exchange Rates in International Law: The Chinese Yuan, ASIL Insight 118 (November 2003).

[25]For a full summary of all initiatives, see Morrison/Labonte, China's Currency: Economic Issues and Options for U.S. Trade Policy, CRS Report for Congress RL 32165, Updated 9 January 2008, pp. 45 et seq.

a designation of currency manipulation were to be made, but were soft on the consequences, i.e. required only negotiations with the respective country.[26] Other proposals added a mix of different retaliatory measures, such as taking into account the determined currency manipulation in anti-dumping investigations or banning federal procurement of goods and services from the designated country. Another interesting proposal, the "Ryan–Hunter Bill" envisaged the imposition of countervailing duties on all Chinese imports, arguing that the exchange-rate policy pursued by China effectively constituted a prohibited export subsidy on Chinese goods exported into the United States.[27] The legality of such countervailing duties under WTO rules, namely the GATT and the Agreement on Subsidies and Countervailing measures is, however, questionable, as we shall see later.

Currency Manipulations and International Economic Law

Most initiatives taken by US industries inside or outside the United States' Congress build upon the assumption that China's exchange rate policies are in breach of its obligations arising from public international law sources, and that these sources confer a right on the United States to react in a particular way, e.g. by imposing countervailing duties. In the following, we will analyse these allegations, beginning with the general starting point of every public international law analysis, i.e. sovereign equality. We will then turn to obligations regarding exchange-rate policies arising from the Articles of Agreement of the International Monetary Fund (IMF), and to the Agreements entered into under the umbrella of the World Trade Organization (WTO).

Monetary Sovereignty in Public International Law

The power over money has persistently been regarded as one of the core elements of statehood since the development of the notion of "sovereignty" by Jean Bodin.[28] The emergence of national currencies as such, i.e. money that is distinct and exclusive to the territory of a State, is seen as closely related to the formation of

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[26]See in particular the Currency Reform and Financial Markets Access Act of 2007 (S. 1677 [110th]).

[27]For a discussion of the proposal, see Bacchus/Shapiro, Re: The Consistency with the WTO Obligations of the United States of H.R. 1498, the Hunter–Ryan bill, Letter to the Chairman of the International Economic Affairs Policy Group, National Association of Manufacturers, 12 September 2006.

[28]Bodin, *Les six livres de la République*, 1583, Chap. X, p. 211 (223).

Nation States in modern times,[29] and the use of the respective legal tender has often been coerced by authorities upon citizens.[30] Money is considered as a symbol of national independence as well as integration and identity. In the words of John Stuart Mill:

> So much barbarism still remains in the transactions of the most civilized nations, that almost all independent countries choose to assert their nationality by having, to their own inconvenience and that of their neighbours, a peculiar currency of their own.[31]

The presumption that an independent state would normally also have its own currency is also implied in the IMF Statute. At its conclusion in 1944, it seemed rather unrealistic that an independent country could opt for not having a currency of its own.[32] Public International Law reflects this general acceptance of the state power over money. According to an often quoted decision of the Permanent Court of International Justice in 1929, "[I]t is indeed a generally accepted principle of public international law that a state is entitled to regulate its own currency".[33] The key legal consequence derived from this *ius cudendae monetae* is that the definition of a state's currency to which a reference may be made in contracts, is solely described by the law of that state, the *lex monetae*.[34] It becomes relevant first and foremost in cases of a currency reform or reconstruction such as the introduction of the Euro. Furthermore, in the absence of specific treaty obligations, there will normally be no basis for a legal challenge of another state's measures to organise its monetary system or of its conduct of monetary policy, as long as this does not interfere with the monetary sovereignty of another state, e.g. by state-controlled counterfeiting of foreign currency. Monetary sovereignty encompasses a number of sovereign rights as well as policy tools.[35] Internally, the state is free to define its unit of account, to issue banknotes and coins and to declare them legal tender, to impose criminal sanctions on counterfeiting, to prohibit the use of other currencies inside its territory, to regulate the money supply and the banking system, and to determine and change the value of its currency. Externally, states may impose exchange restrictions and controls on the flow of capital and

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[29] Helleiner, The *Making of National Money: Territorial Currencies in Historical Perspective*, 2003.

[30] Simmel, *Philosophie des Geldes*, (5th ed.) 1930, p. 173.

[31] Mill, *Principles of Political Economy*, 1848/1909, p. 615.

[32] See Gianviti, Use of a Foreign Currency Under the IMF's Articles of Agreement, in: IMF (ed.), Current Developments in Monetary and Financial Law, Vol. 3, 2005, pp. 817 et seq.

[33] PCIJ, Case concerning the Payment of Various Loans Issued in France, Judgment of 12 July 1929, Series A, No. 20/1, p. 44.

[34] Cf. Proctor, *Mann on the Legal Aspect of Money*, (6th Ed.) 2005, pp. 331 et seq. and pp. 499 et seq.

[35] On these elements, see Gianviti, Current Legal Aspects of Monetary Sovereignty, in: IMF (ed.), Current Developments in Monetary and Financial Law, Vol. 4, 2005, p. 1; Lastra, Legal Foundations of International Monetary Stability, 2006, pp. 22 et seq.; Proctor, *Mann on the Legal Aspect of Money*, 2005, pp. 500 et seq.

payments, opt for a floating or fixed exchange-rate regime, and define the exchange rate vis-à-vis other currencies.

Exchange Rate Disciplines Under the IMF Articles of Agreement

The IMF Articles of Agreement as Legal Backbone of International Monetary Law

The sovereign rights of a state are limited by the provisions of international agreements it has entered into. With regard to monetary sovereignty, the main source for such limitations is the Articles of Agreement of the International Monetary Fund (IMF).[36] With its 185 member countries, the IMF constitutes the virtually universal legal framework for the exercise of monetary sovereignty.[37]

Obligations Regarding Member's Choice of an Exchange Rate System

The IMF Articles' provisions on exchange-rate systems belong to the most important, but at the same time most difficult and complicated provisions of the entire agreement. They are nothing less than decisive for a key feature of the international monetary order. Since the second amendment to the Articles, which came into force in 1978 and was designed to adapt the legal framework to the practice of freely floating exchange rates that had emerged with the breakdown of the par value system in the early 1970s,[38] members of the IMF are in principle free to decide to fix or float the exchange rate of their currency against other currencies (Art. IV Sec. 2 (b) IMF). Even though one of the main purposes of the IMF is "to promote exchange stability, to maintain orderly exchange arrangements amongst members and to avoid competitive exchange depreciation" (see Art. I (iii) IMF), there is "no clearly defined and self-standing legal duty to maintain stable currencies" presently laid down in the IMF Articles.[39]

The diversity of exchange rate systems established by IMF members on the basis of this freedom of choice could hardly be greater. It reaches from choosing a foreign currency as legal tender (so-called "dollarisation", ten IMF members) over currency board arrangements (13 IMF members), other conventional fixed-peg

[36]On the law of the IMF in general, see Lastra, *Legal Foundations of International Monetary Stability*, 2006, pp. 371 et seq.; Lowenfeld, *International Economic Law*, 2002, pp. 529 et seq.; Proctor, *Mann on the Legal Aspect of Money*, (6th Ed.) 2005, pp. 557 et seq.

[37]A list of the members can be consulted at http://www.imf.org/external/np/sec/memdir/members.htm.

[38]On the fixed exchange regime between 1945 and 1971 and on the transition to the new system, see Lowenfeld, *International Economic Law*, 2002, pp. 524 et seq.

[39]Proctor, *Mann on the Legal Aspect of Money*, 6th Ed., 2005, p. 564.

arrangements (70 IMF members) and managed floating with no predetermined path for the exchange rate (48 IMF members) to independently floating exchange rates [35 (mainly industrialized) IMF members including the Euro area].[40]

The Obligation to "Avoid Manipulating Exchange Rates"

An explicit and "hard" prohibition of "exchange rate manipulation" is laid down in Art. IV Sec. 1 (iii) IMF. According to this proviso "each member shall [. . .] avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members". The interpretation of Art. IV Sec. 1 (iii) is made more complicated by Art. IV Sec. 1 (ii) IMF, which obliges members to "seek to promote stability by fostering [. . .] a monetary system that does not tend to produce erratic disruptions". From the general freedom of choice regarding the exchange rate regime and from the obligation to promote stability, one can derive that intervention in foreign exchange markets as such cannot be a breach of the IMF Articles of Agreement. A currency peg, which is unquestionably legal under IMF rules, cannot be upheld without interventions by the respective monetary authority. The question is, when does a legal and legitimate policy of intervention turn into illegal and illegitimate manipulation? What exactly is meant by the IMF Articles' term "manipulating exchange rates" is not defined by the agreement itself. Moreover, it was left to the IMF bodies to develop a more precise concept of exchange rate manipulation in practice. The only firm conclusion that can be drawn on the basis of Art. IV Sec. 1 (iii) IMF alone is that an objective element ("manipulation of exchange rates") and a subjective element ("in order to") must be fulfilled to qualify an exchange rate policy as illegal under Art. IV Sec. 1 (iii) IMF. A number of interpretative questions are raised by Art. IV Sec. 1 (iii) IMF,[41] among them whether an active behaviour on the part of the alleged "manipulator" is required, whether a movement of the exchange rate is necessary or whether the prevention of movement would suffice, and last but not least which role manifold intentions for the intervention play or how to inquire into the motive of a country.[42]

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[40]See International Monetary Fund, Annual Report on Exchange Arrangements and Exchange Restrictions 2007, pp. XXV et seq. On the legal differences between the several types of arrangements, see Proctor, *Mann on the Legal Aspect of Money*, (6th Ed.), 2005, pp. 566 et seq.

[41]See Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Norton/Andenas (eds.), *International Monetary and Financial Law upon Entering the New Millennium*, 2002, p. 29 (pp. 38 et seq.); Gold, *Exchange Rates in International Law and Organization*, 1988, pp. 108 et seq.; IMF Legal Department, Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework, 28 June 2006; Lowenfeld, *International Economic Law*, 2002, pp. 534 et seq.

[42]Cf. Gold, *Exchange Rates in International Law and Organization*, 1988, p. 109.

Exchange Rate Surveillance by the IMF

Legal Foundation of Surveillance

Art. IV Sec. 3 (a) of the Articles of Agreement obliges the IMF to "oversee the international monetary system in order to ensure its effective operation, and [...] the compliance of each member with its obligations under Section 1 of this Article". Paragraph (b) empowers the IMF to "exercise firm surveillance over the exchange rate policies of members" and to "adopt specific principles for the guidance of all members with respect to those policies". These principles shall be consistent with cooperative exchange arrangements of IMF members and "shall respect the domestic social and political policies of members". In applying the principles, "the Fund shall pay due regard to the circumstances of members". The IMF members, on this basis, are obliged to provide the Fund with the necessary information and consult with the Fund, when requested, on their exchange rate policies. Surveillance takes place as a bilateral process between the IMF and its members, with an assessment of members' policies by IMF staff and subsequent consultations between the IMF and the monetary authorities of the respective country.[43]

The 1977 and 2007 Decisions on Surveillance

The principles referred to in Art. IV Sec. 2 (b) IMF were initially laid down in the IMF Executive Directors' "Decision on Surveillance over Exchange Rate Policies" of 29 April 1977.[44] The 1977 Decision identified a number of developments that should be "considered" by the Fund and "indicate the need for discussion with a member", with "protracted large-scale intervention in one direction in the exchange market" being the most precise among them. The 1977 Decision served as the legal foundation for 30 years of IMF surveillance practice, which, however, led only twice to ad hoc consultations ("discussions") with members on their exchange rate policies, with Sweden in 1982 and South Korea in 1987.[45] An illegal manipulation of exchange rates was never determined by the IMF in the process of bilateral surveillance.[46] Generally, exchange rate policies played a minor role in the consultation process.[47] Instead, the IMF increasingly focused on other areas of members'

[43]For the practical aspects of surveillance cf. Lastra, *Legal Foundations of International Monetary Stability*, 2006, pp. 399 et seq.; Lowenfeld, *International Economic Law*, 2002, pp. 541 et seq.

[44]Executive Board Decision No. 5392-(77/63).

[45]Goldstein, Currency Manipulation and Enforcing the Rules of the International Monetary System, in: Truman (ed.), *Reforming the IMF for the 21st Century*, 2006, p. 141 (150).

[46]Hufbauer/Wong/Sheth, US–*China Trade Disputes: Rising Tide, Rising Stakes*, 2006, p. 26.

[47]For an assessment of the surveillance practice, see Independent Evaluation Office of the IMF, IMF Exchange Rate Policy Advice, Evaluation Report, 2007.

economic policies, even though the IMF mandate as well as members' obligations in that regard were much weaker. For this reason, the former General Counsel of the IMF, François Gianviti, concluded that Art. IV IMF had been de facto transformed into "soft law".[48]

After a year-long review process,[49] the 1977 Decision was replaced by a new Executive Board "Decision on Bilateral Surveillance over Members' Policies" on 15 June 2007.[50] It "clarifies the concept of exchange rate manipulation in order to gain an unfair competitive advantage over other members".[51] In many ways, the 2007 Decision resembles the 1977 Decision. However, it does also contain some new language that might be the basis for a tighter surveillance over IMF members' exchange rate policies than in the past decades.

Like the 1977 Decision, the 2007 Decision does not impose additional obligations on IMF members. Moreover, it "provides guidance" to the Fund and to members with regard to questions of exchange rate policies and surveillance. In applying the principles, "the Fund will give the member the benefit of any reasonable doubt". More generally, "[m]embers are presumed to be implementing policies that are consistent with the principles". Principle A reiterates the obligation contained in Art. IV Sec. 1 (iii) IMF; the other principles (B through D) are explicitly labelled as containing only recommendations, but confirm the assumption that interventions in exchange markets are not generally prohibited by the IMF Articles of Agreement. Like the 1977 Decision, the 2007 Decision then describes "developments" which the Fund shall consider in its surveillance of observance of the principles by members "as among those which would require thorough review and might indicate the need for a discussion with a member". Whereas the developments described in subparagraphs (i), (iii), and (iv) are identical to those in the 1977 Decision, subparagraphs (ii), (v), (vi) and (vii) are phrased differently and introduce new concepts into the analysis. In subparagraph (ii), the "excessive and prolonged official or quasi-official accumulation of foreign assets" is added; subparagraph (v) lists "fundamental exchange rate misalignments", subparagraph (vi) adds "large and prolonged current account deficits or surpluses" to the indicative

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[48]Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Norton/Andenas (eds.), *International Monetary and Financial Law upon Entering the New Millennium*, 2002, p. 29 (47).

[49]The following IMF documents contain large parts of the discussions: Review of the 1977 Decision on Surveillance Over Exchange Rate Policies — Preliminary Considerations, 28 June 2006; — Background Information, 30 June 2006; — Summing Up of the Executive Board Meeting, 19 July 2006; — Further Considerations, 11 January 2007; — Summing Up of the Executive Board Meeting, 14 February 2007; — Companion Paper, 22 May 2007; — Proposal for a New Decision Supplement, 13 June 2007; 1 year after the adoption of the 2007 Decision, a further document, entitled Guidance on Operational Aspects of the 2007 Surveillance Decision, 4 August 2008, was published; all documents are available at http://www.imf.org.

[50]See IMF Public Information Notice (PIN) No. 07/69, 21 June 2007.

[51]IMF, Public Information Notice (PIN) No. 07/69, p. 2.

list.[52] Further guidance regarding the meaning of Art. IV Sec. 1 (iii) is contained in an Annex to the 2007 Decision. This annex repeats that "a member will only be acting inconsistently with Article IV, Section 1 (iii) if the Fund determined both that: (a) the member was manipulating its exchange rate [. . .] and (b) such manipulation was being carried out for one of the two purposes specifically identified in Article IV, Section 1 (iii)". Furthermore, the Annex clarifies the meaning of manipulation, stating that a "manipulation of the exchange rate is only carried out through policies that are targeted at — and actually affect — the level of an exchange rate" and that a "manipulation may cause the exchange rate to move or may prevent such movement". Domestic economic and fiscal policies, even if they also may have an effect on the exchange rate, will usually not be "targeted" at it and will therefore be out of the picture. The Annex also contains some guidance regarding the subjective test foreseen in Art. IV Sec. 1 (iii) IMF. According to paragraph 2, subparagraph (b) of the Annex, the intention to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members will require a determination by the Fund that "(A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports". The last paragraph of the Annex stresses that it is for the Fund to make an objective assessment of whether a member complies with its obligations under Art. IV Sec. 1 (iii) IMF, but that "[a]ny representation made by the member regarding the purpose of its policies will be given the benefit of any reasonable doubt". In sum, the 2007 Decision clarifies the objective test for an exchange rate manipulation significantly. However, it does not — and cannot — waive the need to prove a specific intention on behalf of the alleged manipulator.

Whereas it is clear that China's exchange rate policy fulfils at least some of the "developments" indicating the need for discussion (in particular (i), (ii) and (vi)), it seems much less clear that China would fail the subjective test required by Art. IV Sec. 1 (iii) IMF as clarified by the Annex of the 2007 Decision. As has been pointed out repeatedly, China may have a greater set of reasons for its exchange rate policy than a plain mercantilist export expansion intention, and the macroeconomic and trade effects of the exchange rate policy seem much more complicated than sometimes assumed. Art. IV Sec. 3 (b) IMF directs the Fund to have due regard to possible domestic policy choices. It seems hence still rather unlikely that the IMF would arrive at a clear finding of exchange rate manipulation by the People's Republic of China as forbidden by the IMF Articles of Agreement, even though the likelihood of ad hoc consultations on the matter may have increased.[53]

[52]The last development (vii) is of not of interest in the case of exchange rate manipulation as discussed in this contribution, but is rather designed for cases such as the Asian crisis of 1997/1998.

[53]Hartquist/Beckington/Collis, China's Policy of Substantially Undervaluing the Renminbi: A Challenge for the International Monetary and Trading System, Research Paper Prepared by the Trade Law Advisory Group, 15 September 2008, p. 23, speculate that such ad hoc consultations might actually be considered at present.

Consequences of a Possible Finding of Exchange Rate Manipulation

Even if the IMF found that China had illegally manipulated its exchange rate in order to gain an unfair competitive advantage, the consequences of such a finding are unclear, at best. In contrast to the WTO legal order or other international economic agreements, the IMF Articles of Agreement do not provide an effective mechanism for solving disputes between IMF members, nor do they grant an effective sanctioning power to the IMF bodies. Within the course of Art. IV consultations, the IMF may address recommendations to the member concerned which arguably would be binding on the member as a part of its obligation to cooperate. However, if the member did not comply with these recommendations, the enforcement power of the Fund is very limited. Art. XXVI Sec. 2 IMF contains a tiered catalogue of possible sanctions that may be applied to members not fulfilling any of their obligations under the IMF Articles of Agreement: a declaration of ineligibility to use the Funds resources (a), a suspension of the voting rights (b) and lastly a request to withdraw from the Fund (c).[54] Whereas options (b) and (c) with their 70% and 85% (super) qualified majorities are very unlikely to be employed against a politically and economically important IMF member like China (possibly to the benefit of the international monetary system), option (a) is an idle threat to countries possessing the largest parts of the world's foreign currency reserves.[55]

As regards disputes between IMF members over the interpretation of the Articles of Agreement, Art. XXIX IMF delegates the authority to give binding interpretations to the IMF Executive Board and the Board of Governors, preceded by a decision of the Committee on Interpretation. However, such interpretation only clarifies the meaning of obligations; it does not enforce them, and the procedure has only been used a few times decades ago. A mechanism of enforcement by retaliation, akin to the WTO's dispute settlement system, is not foreseen in the IMF Articles of Agreement.

Exchange Rate Manipulation and WTO Law

Introduction

Given the inability of the IMF legal system to effectively deal with alleged breaches of its obligations, it is hardly surprising that critics of China's exchange rate policy turn to the WTO, which provides for one of the most effective dispute settlement and enforcement mechanisms in international law. Given the common historical roots of the IMF and the GATT and the possible trade impacts of exchange rates,

[54] For an in-depth analysis of the IMF sanctions regime, see Gold, *Legal and Institutional Aspects of the International Monetary System: Selected Essays*, 1979, pp. 148 et seq.

[55] Staiger/Sykes, "Currency Manipulation" and World Trade, NBER Working Paper 14600, p. 28.

however difficult to quantify they may be, it is also logical to include the WTO legal framework in the analysis. Furthermore, some of the reactions suggested in the United States would use trade contingency measures to counteract China's exchange rate policy. The legality of such a response, however, is governed by the WTO agreements. Two issues must be addressed in that regard. Firstly, does China's exchange rate policy amount to a breach of any provision of the WTO agreements? Secondly, does it qualify as a prohibited, actionable and countervailable export subsidy?[56]

Exchange Rate Manipulation as Breach of Art. XV GATT

The WTO agreements contain numerous provisions that deal with questions of exchange rates, balance of payments and other monetary or financial matters, in particular provisions answering the question as to which exchange rate must be chosen in different situations where calculations of duties etc. are to be made.[57] However, only Art. XV GATT explicitly addresses "exchange arrangements" and "exchange action", but not "exchange rate policies". The central obligation usually referred to in the context of the discussion of exchange rate manipulation is laid down in Art. XV:4 GATT. According to that proviso, "[WTO members] shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund". Exchange rates do certainly not lie at the heart of the provision's scope, and it is doubtful whether exchange rate policies can be caught by it at all. The prime focus of Art. XV GATT in general is on exchange restrictions and multiple exchange rates, measures with similar effects to those of quantitative restrictions and discriminatory tariffs.[58] Exchange rates have within the framework of GATT traditionally rather been discussed as a source of instability in case of fluctuations.[59] No evidence can be found that an alleged manipulation of an exchange rate has ever been brought before the GATT or the WTO to date.[60]

The lack of positive precedence does of course not preclude the application of Art. XV:4 GATT to a manipulation of an exchange rate which is carried out with a view to increasing exports and reducing imports. However, as has been pointed out

[56]On these different "scenarios" of WTO involvement, see Ciobănaşu/Denters, Manipulation of the Chinese Yuan — May WTO Members Respond? SSRN Working Paper, p. 10, available at http://sssrn.com/abstract=1315290.

[57]For details, see WTO, Note by the Secretariat, WTO Provisions Relevant to the Relationship Between Trade and Finance and Trade and Debt, WT/WGTDF/W/3.

[58]See WTO, Note by the Secretariat, WTO Provisions Relevant to the Relationship Between Trade and Finance and Trade and Debt, WT/WGTDF/W/3, para. 4.

[59]See GATT CONTRACTING PARTIES, Decision L 57/61, November 30, 1984, 31S/15.

[60]Cf. WTO, Note by the Secretariat, WTO Provisions Relevant to the Relationship Between Trade and Finance and Trade and Debt, WT/WGTDF/W/3, pp. 13 et seq.; Jackson, *World Trade and the Law of GATT*, 1969, pp. 479 et seq.

by Denters, the IMF Articles of Agreement differentiate between exchange policies and exchange rate policies.[61] There are good reasons to assume that Art. XV:4 GATT, when speaking of "exchange action", only refers to "exchange policies" in the IMF sense, i.e. the question of convertibility, but not to exchange rate policies. Firstly, Art. XV:1 GATT puts special emphasis on "quantitative restrictions", to which exchange restrictions form the IMF correlate. Furthermore, Art. XV:9 GATT, which provides for an exemption from Art. XV GATT, including its paragraph 4, explicitly speaks of exchange controls and exchange restrictions. Secondly, when the GATT was drafted, there was no need to waste thought on exchange rate manipulation by GATT members, because as IMF members they had to seek the permission of the IMF for changes in the par values of their currencies anyway. These par values, consequentially, serve as the usual reference exchange rates in the GATT (cf. e.g. Art. II:6 (a) and Art. VII:4 (a) GATT).

Even if one considered "exchange action" to embrace a manipulative exchange rate policy as well, it is not clear, the intent of which *GATT* provision[62] could be frustrated by such policy.[63] The only provision that one could argue would be "frustrated" by exchange rate manipulation would be an explicit prohibition of export subsidies. However, such prohibition was not written into the original GATT. The legal constraints to export subsidization imposed by Art. XVI GATT as amended 1955 are not very strong and — something we will return to shortly — define an export subsidy as a subsidy that "results in the sale of such product for export at a price lower than the comparable price charged for the like products to buyers in the domestic market". However, no such effect occurs in the case of exchange rate manipulation, since it does not lead to a price spread between domestic sales and export sales. The same holds true for the alleged frustration of tariff bindings that is put forward occasionally.[64] In contrast to across-the-board tariffs, an exchange rate manipulation does not increase the price of imports in comparison with world market prices, but it translates into higher prices expressed in local currency.

Generally, Art. XV GATT is on the one hand aimed at preserving the competences of the IMF and the WTO vis-à-vis each other; on the other hand, it is inspired by the idea of complementarity and conflict avoidance. Measures legally taken under either regime shall not be forbidden by the other. In case of a dispute initiated by the USA against China claiming an illegal exchange rate manipulation, the Panel and the Appellate Body would thus have to consult the IMF (see in particular

[61]Denters, Manipulation of Exchange Rates in International Law: The Chinese Yuan, ASIL Insight 118 (November 2003).

[62]There is no legal basis for including other WTO agreements in the circle of provisions which must not be frustrated, as suggested by Staiger/Sykes, "Currency Manipulation" and World Trade, NBER Working Paper 14600, p. 30.

[63]For a discussion of this point, see Hufbauer/Wong/Sheth, *US–China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 17 et seq.

[64]Staiger/Sykes, "Currency Manipulation" and World Trade, NBER Working Paper 14600, p. 30.

Art. XV:1 and Art. XV:2 GATT) with regard to the legality of China's exchange rate regime from an IMF law perspective. The basis for these consultations is laid down in the Agreement between the International Monetary Fund and the World Trade Organization, in particular paragraph 8 thereof.[65] However, such advice could only be sought by a Panel if one considered the exchange rate policy as "exchange action" in the sense of Art. XV:4 GATT. However, the staff reports and other related documents relating to Art. IV IMF consultations may only be communicated under paragraph 11 of the agreement for the confidential use of the WTO Secretariat, and subject to the consent of the member concerned. The discerning of exchange action (paragraph 8), and Art. IV consultations (paragraph 11) further support the view that exchange rate policies are not included in the notion "exchange action".

Exchange Rate Manipulation as Prohibited Export Subsidy

Whereas the provisions on subsidies in the GATT were quite weak, the WTO Agreement on Subsidies and Countervailing Measures (ASCM) entered into under the umbrella of the WTO Agreement explicitly bans export subsidies. However, the similar effect on trade flows that an exchange rate manipulation may have does not necessarily mean that it legally qualifies as a prohibited export subsidy under the ASCM. To be found a prohibited export subsidy under Art. 1, 2 and 3 ASCM, it would be necessary to determine that the Chinese exchange rate policy entails a governmental "financial contribution" (Art. 1.1(a) ASCM) which is "contingent, in law or in fact, upon export performance" (Art. 1.2, 2.3, 3.1 ASCM) and confers a "benefit" on its recipients (Art. 1.1(b) ASCM). As Benitah has concluded, "[c]hallenging China's exchange rate as a subsidy in the WTO would not be easy. Nevertheless, it might be possible in this case to satisfy all three of the WTO criteria for an actionable subsidy". Other commentators' scepticism about the validity of an ASCM claim is more pronounced.[66] Indeed, all three criteria are very difficult to apply to an undervalued exchange rate, as has been discussed

[65]See WTO Document WT/L/195 of 18 November 1996. On this topic, see Ahn, Linkages between International Financial and Trade Institutions, JWT 2000, p. 1; Roessler, The Relationship between the World Trade Order and the International Monetary System, in: Petersmann/Hilf (eds.), *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems*, (2nd ed.) 1991, p. 363; Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements, AJIL (2002), p. 561.

[66]Cf. Bacchus/Shapiro, Re: The Consistency with the WTO Obligations of the United States of H. R. 1498, the Hunter–Ryan bill, Letter to the Chairman of the International Economic Affairs Policy Group, National Association of Manufacturers, 12 September 2006; Hufbauer/Wong/Sheth, *US–China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 20 et seq.; Staiger/Sykes, "Currency Manipulation" and World Trade, NBER Working Paper 14600, pp. 31 et seq.

exhaustively in literature and legal briefs.[67] Firstly, the measures taken by China to operate the accused exchange rate regime do not fall into any of the categories listed as "financial contributions" in the sense of Art. 1.1(a) ASCM. Secondly, it is not entirely clear what benefit is conferred to exporters as a consequence of the undervalued exchange rate. Is it the greater amount of yuan they receive in return for the US dollars which they have earned? But what if they charged yuan prices in the first place? Or is it the greater earnings due to more sales following the lower price? But what if their profits had been higher with fewer sales at higher prices? Thirdly, the "benefit" conferred — if any — is not contingent on export performance, since the exchange rate applies to all sorts of transactions, including transfers for direct investment in China.[68] Furthermore, in the interpretation of Art. 1, 2 and 3 ASCM, a look back at Art. XVI:4 GATT seems useful. This proviso defines export subsidies by reference to a comparison between the domestic and export price. At first glance, this seems to be an anti-dumping logic. However, it is exactly this element of AD-logic that is hidden behind the wording of Art. 3 ASCM. Since an undervalued exchange rate does not confer a benefit to an exporter as compared with an undertaking selling its produce on the domestic markets, the qualification of such a policy as a prohibited export subsidy would be unjustified. If one assumed to the contrary, a WTO panel would be charged with the difficult task of assessing the amount of the benefit conferred. This would include the determination of the "correct" market exchange rate and the amount of undervaluation, an exercise not even the specialised IMF staff truly dares to undertake, given the difficulties in assessing which exchange rate would prevail under a floating regime.[69]

[67]See Benitah, China's Fixed Exchange Rate for the Yuan: Could the United States Challenge It in the WTO as a Subsidy, ASIL Insight 117, October 2003; Ciobănaşu/Denters, Manipulation of the Chinese Yuan — May WTO Beiträge zum Transnationalen Wirtschaftsrecht, Issue 77, Halle, August 2008, pp. 26 et seq.; Members Respond?, SSRN Working Paper, available at http://sssrn.com/abstract=1315290; Franke, Chinas Währungspolitik in der Kritik des US-amerikanischen und des internationalen Wirtschaftsrechts, Hufbauer/Wong/Sheth (eds.), *US–China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 20 et seq.; Staiger/Sykes, "Currency Manipulation" and World Trade, NBER Working Paper 14600, pp. 31 et seq.; Zimmermann, Fundamental Exchange Rate Misalignment and International Law, SSRN Working Paper, available at http://ssrn.com/abract=1300542; For an overview of the different positions expressed on the matter, see A Survey of Views Regarding Whether Exchange-Rate Misalignment Is a Countervailable, Prohibited Export Subsidy Under the Agreements of the World Trade Organization (WTO), April 2007, available at http://www.chinacurrencycoalition.org.

[68]Bacchus/Shapiro, Re: The Consistency with the WTO Obligations of the United States of H.R. 1498, the Hunter–Ryan bill, Letter to the Chairman of the International Economic Affairs Policy Group, National Association of Manufacturers, 12 September 2006.

[69]To use just the most obvious example: The exchange rate between the euro and the US dollar fluctuated between approximately 85 ct = 1 euro and 1,60 US dollar = 1 euro during the last ten years. This amounts to a devaluation of the dollar of almost 50%, which does certainly not completely reflect differences in inflation rates, etc.

A Separate WTO Exchange Rate Agreement?

Given the difficulties in finding a clear prohibition of exchange rate manipulation in the WTO agreements, and the lack of dispute settlement and enforcement mechanisms in the IMF, Mattoo and Subramanian have suggested additional rules to be negotiated and concluded within the framework of the WTO, in order to make WTO dispute settlement available for the enforcement of a prohibition of exchange rate manipulation.[70] Firstly, it seems more than just unlikely that such extra agreement would be concluded under the WTO umbrella, given the consensus requirement applying to WTO decision making.[71] Furthermore, Pascal Lamy, the Director General of the WTO rather seems to disapprove of the idea.[72]

Essentially, the proposal would combine the objective criteria of the definition of exchange rate manipulation already enshrined in the IMF Articles of Agreement and in the 2007 Decision with the enforcement mechanism of the WTO. The responsibility for the determination that an exchange rate is undervalued would remain with the IMF, and a consultation mechanism similar to the one already in place would apply. Within the IMF, the information supplied to the WTO would have to be authorised at a high-level, i.e. by the Managing Directors or the Executive Board. However, from a perspective of institutional decision-making, the proposal seems problematic. Within the IMF bodies that would take the prejudicial decisions whether or not a currency was significantly undervalued, weighted voting rules apply which give the USA by far the greatest voting power. It seems inadequate to outsource a question of such importance and political sensitivity to another institution governed by completely different decision-making procedures, the application of which would — in combination with the negative consensus applying in WTO dispute settlement proceedings — amount to a quasi-automatic condemnation once the misalignment had been found. The institutional design proposed would also deviate significantly from the one we find in comparably sensitive areas, namely the question of WTO compatibility of regional trade agreements.

[70] Mattoo/Subramanian, Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization, Peterson Institute for International Economics, Working Paper WP 08-2, January 2008.

[71] It is worth recalling at this point that China objected to the adoption of the 2007 Decision. However, the weighted voting applied in the IMF did work against China, which — contrary to the US — has no veto power in the institution.

[72] See Reuters India, Leave Currency Surveillance to IMF — WTO head, 23 October 2007, available at http://in.reuters.com.

Conclusion

An analysis of the rules of international economic law applicable to exchange rate policies does not provide a clear-cut or easy answer. Certainly, an argument can be made that China is not entirely in line with its obligations under Art. IV Sec. 1 (iii) IMF, even though there is widespread consensus that it is almost impossible to determine the correct exchange rate for a currency. However, it would be extremely difficult to prove that China is manipulating the exchange rate of the yuan in order to gain an unfair competitive advantage, as required by the IMF Articles of Agreement. Even if a breach of the IMF Articles could be determined, the IMF does not possess effective sanctioning power to enforce the obligations. Such enforcement and sanctioning power rests — to some extent — with the WTO, but even the intentional devaluation or suppression of the exchange rate does not necessarily — as I have tried to point out — infringe the WTO agreements. The US administration is hence well-advised not to take too aggressive a stance towards China on the matter, irrespective of the problem of fiscal dependency.

The analysis hence seems to expose a loophole in the international legal order governing international economic relations. Yet this is only true if one takes adjudicability before the WTO as the only relevant benchmark and does not consider the IMF consultation mechanism as relevant. The reason for this "loop-hole" is rather easily explainable. When the IMF Articles and the GATT were initially concluded, it was clear that exchange rates would be a matter exclusively dealt with by the IMF under its par value regime. Competitive depreciations seemed unlikely, with the requirement of IMF authorization for devaluations. With the breakdown of the par value regime, matters have become more complicated, and IMF members have gained additional policy options which may also be abused. However, at that time, in the 1970s, enforceable, "hard" rules were not common and it took almost 20 more years to make the GATT more biting. It is hardly surprising that a matter of such enormous political sensitivity and importance is not subject to the same legal review standards as the use of technical trade measures such as quantitative restrictions, customs duties and the like.

Surprisingly enough, the call to drag China before the DSB comes from the United States, which was hitherto not truly known as an enthusiastic supporter of the WTO's dispute settlement and enforcement mechanism and the restrictions on sovereignty deriving from it. Not to mention the unwillingness to subordinate any of its policies to international judicial review. At the end of the day, the exchange rate question may be one of the matters where lawyers must give way and leave the field to diplomacy. The sheer size and paramount importance of the matter puts its justiciability into question. This does not mean that international economic law has no role to play in the matter. The mere existence of rules may already be of influence in diplomatic discussions, since it makes it possible to point at behaviour and label it "illegal", even though this accusation is without legal consequences strictu sensu.

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