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Congress Continues to Attack Currency Manipulation as China Defuses G-20 Pressure For Now: the International Law Issues

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Introduction

On Saturday, June 19, 2010, one week before the G-20 Toronto Summit, China's central bank announced that it would increase the exchange rate flexibility of the renminbi ("RMB"),[1] but emphasized that it did not see the economic basis for a large-scale appreciation of the RMB.[2] Policymakers around the world welcomed China's announcement as a constructive step but stressed that, as put by United States ("U.S.") Treasury Secretary Timothy Geithner, "the test will be how far and how fast [the Chinese] let the currency appreciate."[3] Skeptics were confirmed in their view when China's central bank stated that there would be no one-off adjustment of the RMB exchange rate, that the RMB's daily 0.5 % trading band against the U.S. dollar ("USD") would not change, and that the rate would be flexible "in both directions" (i.e. could move up or down).[4] A week later, the RMB had risen by only 0.5 percent against the USD.[5]

At the G-20 Toronto Summit (June 26-27, 2010), an explicit statement welcoming China's announced policy shift was dropped from the final version of the Summit Declaration upon Chinese request. This demonstrated once again China's sensitivity over its exchange rate policy, which it insists is a purely domestic issue.[6] Whereas a week before the summit, the Chinese exchange rate had promised to overshadow everything else,[7] the Summit Declaration now merely states that emerging surplus economies "will undertake reforms tailored to country circumstances" in order to, among other things, "[e]nhance exchange rate flexibility to reflect underlying economic fundamentals."[8] U.S. President Barack Obama told reporters at the G-20 Summit that the U.S. "didn't expect 20% revaluation in a week," but that it will be watching over the next "several months," expecting to see the RMB/USD rate appreciate.[9]

The policy shift announced by China comes at a time when political pressure on the U.S. Administration for a tougher approach against China is once again rising.[10] China has long been criticized for maintaining a significantly

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undervalued exchange rate peg to the USD as part of a strategy of export-led growth.[11] Following the Chinese announcements of June 19-20, New York Senator Charles Schumer (D) stressed that this merely "vindicated [his] initial skepticism," reiterating his determination to press ahead with his bipartisan legislation on the issue.[12] With the G-20 summit past, Congress may continue its saber-rattling to encourage China to let the RMB appreciate faster – and U.S. industry will continue to seek trade remedies against the RMB exchange rate.

This Insight discusses the international law rules regarding exchange rate manipulation and the U.S. domestic actions proposed to respond to it. It does not take a position on whether China's exchange rate policy violates these rules, because that would require an economic assessment too complex for a brief treatment such as this.

I. Existing International and Domestic Law on Exchange Rate Manipulation

In international law, exchange rates are governed by the Articles of Agreement of the International Monetary Fund ("IMF" or "Fund") ("IMF Agreement"). Article IV:1 of the IMF Agreement requires each member of the Fund to collaborate with the Fund and other members to assure orderly exchange arrangements, and, in particular, to "avoid manipulating exchange rates . . . in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members" (Article IV:1(iii)). In its 2007 Decision on Bilateral Surveillance ("*2007 Decision*"), the Fund clarified that this could mean either causing the exchange rate to move or preventing it from moving "for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate in order to increase net exports."[13] The intent requirement enshrined in Article IV:1(iii) of the IMF Agreement makes it politically very delicate for the IMF to officially find one of its members in breach of that provision.

Recognizing this dilemma, the Fund's *2007 Decision* introduced a new non-binding "principle D," recommending that IMF members avoid exchange rate policies that *result* in external instability, regardless of their purpose. This was intended to flesh out the Article IV obligation for IMF members to collaborate with the Fund and other members, without directly affecting the intent element in Article IV:1(iii). However, if the IMF Executive Board, by providing a binding interpretation of principle D, were to recommend that all members avoid massive accumulations of foreign exchange reserves, then non-respect of principle D could ultimately lead to a finding of breach of the general obligation to collaborate.

Arguably, tying exchange rate policies to the concept of external stability has enhanced the Fund's surveillance of international monetary conduct under IMF Article IV. However, with respect to China's exchange rate peg, the *2007 Decision* has not led to any measurable results.

U.S. law also includes provisions on exchange rates: Title III of the U.S. Omnibus Trade and Competitiveness Act of 1988, inspired by USD misalignment in the 1980s.[14] Title III, too, focuses on intentional exchange rate manipulation. It requires the Treasury Department, in consultation with

The G-20 Toronto Summit Declaration

ORGANIZATIONS OF NOTE

U.S. Department of the Treasury

United States Trade Representative

People's Bank of China

The Group of Twenty

World Trade Organization

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the IMF, to analyze the exchange rate policies of the major U.S. trading partners and to issue reports each year and updates six months thereafter. These reports examine whether countries are manipulating their USD exchange rates "for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade." If Treasury finds such manipulation, the issue should be resolved via negotiations, except "where this would have a serious detrimental impact on vital national and economic and security interests." However, since 1994, no such Treasury report has labeled any country as an exchange rate manipulator.

It is against this background that numerous bills on exchange rate manipulation have been introduced in recent sessions of Congress.

II. Recent Congressional Proposals to Tackle Exchange Rate Manipulation

The leading current proposal is the *Currency Exchange Rate Oversight Reform Act of 2010*, introduced on March 17, 2010 by a bipartisan group of senators led by Charles Schumer (D-NY), Debbie Stabenow (D-MI), and Lindsey Graham (R-SC) ("Schumer-Stabenow-Graham Bill").[15] This bill bridges between the two main competing legislative approaches since 2007.[16] It would replace Title III of the 1988 Act and would require semiannual reports by Treasury (1) identifying "fundamentally misaligned currencies,"[17] and (2) designate such currencies "for priority action" where the country that issues the currency is engaging in actions such as protracted large-scale intervention in the currency exchange market, or excessive and prolonged official or quasi-official accumulation of foreign exchange reserves. For either category, whether the country concerned is acting with the intent to gain unfair competitive advantage would be irrelevant for the assessments undertaken by Treasury.

Upon designation of a currency as "fundamentally misaligned," Treasury would have to consult bilaterally with the country that issues such currency in order to facilitate the adoption of appropriate policies to address the fundamental misalignment. If a currency is designated "for priority action," however, the Schumer-Stabenow-Graham Bill provides for several steps of increasing severeness:

Immediately, the Administration would be required to consult with the IMF and recruit allies to persuade the country to eliminate the fundamental misalignment; also, to oppose any IMF governance changes benefiting a country thus designated (for instance, an increase in China's IMF voting shares). Designation for the priority action list would also affect decisions on a country's nonmarket economy status for anti-dumping investigations.[18]

After ninety days, the Commerce Department would be required to reflect exchange rate undervaluation in calculation of dumping margins; federal procurement of the country's goods and services would be banned (unless it is a party to the World Trade Organization ("WTO") Government Procurement Agreement ("GPA")[19]); the U.S. must request special IMF Article IV consultations with that country and vote against any new multilateral development bank financing to it; and the Overseas Private

Investment Corporation (“OPIC”) must deny financing for any investments there.

After 360 days, the U.S. Trade Representative (“USTR”) would be required to request WTO consultations with the country concerned regarding the WTO-consistency of its actions.[20] Treasury would be required to consult with the Federal Reserve regarding remedial intervention in currency markets, to be coordinated with the IMF and other central banks.

The President could waive any action required under the bill, but would have to publish an explanation of the reasons why. However, such a presidential waiver would cease effect upon enactment of a joint resolution of disapproval. And while the President can veto the joint declaration, the Congress’ authority to override the veto would allow Congress for the first time ever to have the last word on exchange rate policy and its application.

III. Exchange Rate Misalignment and Anti-dumping Duties: A Major Conceptual Inconsistency

The Schumer-Stabenow-Graham Bill requires exchange rate undervaluation to be taken into account when calculating the margin of dumping in anti-dumping investigations. The bill requires the Commerce Department, which administers the U.S. anti-dumping laws, to “ensure a fair comparison between the export price and the normal value by adjusting the price used to establish export price or constructed export price to reflect the fundamental misalignment of the currency of the exporting country.” This adjustment would take place only when a “priority action” country fails to eliminate “fundamental misalignment.” The punitive and automatic nature of the price adjustment thus undertaken undercuts any argument that it provides for a “fair comparison . . . between the export price and the normal value” for the products concerned as required by Article 2.4.2 of the WTO Anti-dumping Agreement (“ADA”).

It is conceptually misguided to adjust dumping margins for exchange rate misalignment. Dumping is a matter of companies’ product pricing decisions, which have nothing to do with the macro-level governmental measures that lead to exchange rate misalignment. If exchange rate undervaluation were to be taken into account in anti-dumping calculations, a product that is not dumped (under normal rules) will suddenly have a dumping margin, which would amount to a violation of the ADA.[21]

The Schumer-Stabenow-Graham Bill also requires Commerce to investigate whether currency undervaluation is providing a countervailable subsidy, but only in response to a countervailing duties (“CVD”)[22] petition; the standing requirement for petitions and the material injury test would mean that such petitions could only be brought on a product-by-product basis. Moreover, the petitioner would still need to prove the existence of a financial contribution, and that the subsidy is specific. Both requirements constitute high hurdles. In two ongoing CVD investigations of Chinese products, Commerce is currently investigating allegations that undervalued exchange rates are a subsidy. A final ruling in one is due by July 12 – it still remains to be seen what Commerce makes of these allegations under existing U.S. law.[23]

Conclusion

In recent years, Congress has threatened to legislate on exchange rate manipulation in a way that very much recalls the saber-rattling that preceded the Plaza Agreement of 1985.[24] If China lets the RMB/USD exchange rate appreciate substantially over the months to come, this legislation will fade away. But from an international law perspective, two points should be stressed with respect to the current main legislative proposals.

First, changing trade remedy rules to take exchange rate undervaluation into account in calculating dumping margins is likely to run afoul of the WTO Agreements. And to the extent that the legislation is mandatory, it can (and likely will) be challenged "as such" in the WTO even before it is ever applied.

Second, where existing U.S. law requires Treasury to determine whether there is intentional exchange rate manipulation, thereby echoing the multilateral key provision in Article IV:1(iii) of the IMF Agreement, the Schumer-Stabenow-Graham Bill and similar proposals shift to objective factors. But this does not resolve the core problem that IMF Article IV:1(iii) still requires a showing of intent, although the Fund's *2007 Decision* has introduced at least some flexibility by tying exchange rate policies to the concept of external stability as discussed in this Insight. Thus, the actions proposed in the Schumer-Stabenow-Graham Bill could push the U.S. into violating the IMF Agreement. For instance, if the U.S. government were to impose unilateral penalties on China for exchange rate misalignment where the IMF has not established a breach of the IMF Agreement, the U.S. might itself be found in breach of the general obligation to cooperate with the Fund and other IMF members as set forth in the chapeau of Article IV of the IMF Agreement.

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Endnotes

[1] *Further Reform the RMB Exchange Rate Regime and Enhance the RMB Exchange Rate Flexibility*, PEOPLE'S BANK OF CHINA, June 19, 2010, *available at* http://www.pbc.gov.cn/english//detail.asp?col=6400&ID=1488.

See, *e.g.,* Keith Bradsher, *China Signals a Gradual Rise in Value of Its Currency*, N.Y. TIMES, June 19, 2010, *available at* http://www.nytimes.com /2010/06/20/business/global/20yuan.html.

[2] Before July 2005, China had operated an outright currency peg with the United States Dollar ("USD"). Over the course of the following three years, the Chinese authorities had let the RMB appreciate by around twenty-one per cent against the USD under a managed float. From July 2008 until the policy shift announced on June 19, 2010, the RMB has been effectively pegged to the USD at around RMB 6.83 per USD.

[3] Geoff Dyer & Alan Beattie, *China Vows Increased Currency Flexibility*, FIN. TIMES, June 19, 2010, *available at* http://www.ft.com/cms/s /0/ac0ca08e-7ba7-11df-aa88-00144feabdc0.html.

[4] Andrew Batson & Aaron Back, *PBOC: No One-Off Adjustment of Yuan*, WALL ST. J., June 20, 2010, *available at* http://online.wsj.com/article/BT-CO-20100620-701742.html?mod=WSJ_latestheadlines.

[5] Geoff Dyer, *Scepticism Mounts Over Renminbi Move*, FIN. TIMES, June 21, 2010, *available at* http://www.ft.com/cms/s/0/1dd37a60-80b9-11df-be5a-00144feabdc0.html.

[6] Brian Love & David Storey, *G20 Drops China-Sensitive Plaudits on Yuan Reform*, REUTERS, June 27, 2010, *available at* http://www.reuters.com /article/idUSTRE65Q1AQ20100627.

[7] Heather Scott, *G20: Obama, Harper Confident China to Follow Thru on FX Policy*, IMARKETNEWS.COM, June 27, 2010, *available at* http://imarketnews.com/node/15593.

[8] *The G-20 Toronto Summit Declaration*, Annex I, § 12 (June 26-27, 2010), *available at* http://g20.gc.ca/toronto-summit/summit-documents/the-g-20-toronto-summit-declaration/.

[9] Scott, *supra* note 7.

[10] *See* Sewell Chan, *Pressure Grows in U.S. Over China's Currency*, N.Y. TIMES, Mar. 16, 2010, *available at* http://www.nytimes.com/2010/03 /17/business/17yuan.html (explaining that members of Congress have written to the Administration and introduced new bipartisan legislation, and U.S. producers have petitioned the Commerce Department and the U.S. Trade Representative ("USTR") to initiate investigations that could lead to the imposition of unilateral trade remedies against China).

[11] By postponing a much-awaited, semi-annual report to Congress on foreign exchange rate policies, originally due by April 15th, Geithner avoided a formal statement on whether Treasury considered China to be a currency manipulator. *See* James Politi, Jamil Anderlini & Alan Beattie, *US Delays Decision on China Currency Manipulation*, FIN. TIMES, Apr. 2, 2010, *available at* http://www.ft.com/cms/s/0/24a3588c-3e98-11df-a706-00144feabdc0.html. This move was generally interpreted as a diplomatic concession to China by the Obama Administration to ensure the

presence of the Chinese President Hu Jintao at the Nuclear Security Summit, hosted by President Obama in Washington on April 12-13, and to gain China's cooperation in sanctions against Iran. In hearings in June, the Senate Finance Committee pressured Geithner to issue the Treasury report and find that China manipulates its currency to gain unfair competitive advantage in trade. Geithner demurred but toughened his rhetoric: "The distortions caused by China's exchange rate spread far beyond China's borders and are an impediment to the global rebalancing we need." Simon Rabinovitch, *Q+A – As Pressure Builds, Will China Let Yuan Rise?*, REUTERS, June 11, 2010, *available at* http://www.reuters.com/article/idUSTOE65A03M20100611.

[12] Dyer & Beattie, *supra* note 3.

[13] *IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies*, Pub. Info. Notice 07/69, INT'L MONETARY FUND [IMF], June 21, 2007, *available at* http://www.imf.org/external/np/sec/pn/2007/pn0769.htm. However, a June 2009 operational guidance note by the Fund on the application of the *2007 Decision* states that labels such as "fundamental exchange rate misalignment" have been an obstacle to implementing this Decision, and reverts to the plain economic terms "under- or overvaluation" instead. *The 2007 Surveillance Decision: Revised Operational Guidance*, INT'L MONETARY FUND [IMF], June 22, 2009, *available at* http://www.imf.org/external/np/pp/eng/2009/062209.pdf.

[14] Omnibus Trade and Competitiveness Act of 1988, §§ 3001-3006, Pub. L. No. 100-418, 102 Stat. 1107 (1988) (codified at 22 U.S.C. §§ 5304-5306), *available at* http://www.ustreas.gov/offices/international-affairs/economic-exchange-rates/authorizing-statute.pdf.

[15] *See* S.3134, 111th Cong. (2009–2010), *available at* http://thomas.loc.gov/cgi-bin/query/z?c111:S.3134: (providing the full text of the Schumer-Stabenow-Graham bill as submitted, and of other legislation cited in this Insight).

[16] The first of these approaches is best represented by the *Currency Exchange Rate Oversight Reform Act of 2007*, S.1607, 110th Cong. (2007), *available at* http://thomas.loc.gov/cgi-bin/query/z?c110:S.1607:. This Schumer-Graham Bill was approved by the Senate Finance Committee, but went no further due to a jurisdictional conflict with the Senate Banking Committee. It was reintroduced in the current Congress on June 11, 2009, as the *Currency Exchange Rate Oversight Reform Act of 2009*, S.1254, 111th Cong. (2009). *Currency Reform for Fair Trade Act of 2009*, S.1027, 111th Cong. (2009), *available at* http://thomas.loc.gov/cgi-bin/query/z?c111:S.1027: (introduced under the leadership of Senators Debbie Stabenow (D-MI) and Jim Bunning (R-KY) stands for the second approach).

[17] Defined by the bill as "significant and sustained undervaluation of the prevailing real effective exchange rate, adjusted for cyclical and transitory factors, from its medium-term equilibrium level."

[18] Dumping exists when the export price of a product is lower than its "normal value" (defined as the home market price, or a price to a third

country market, or the fully-loaded average production cost plus overhead and profit). Article VI of the General Agreement on Tariffs and Trade 1994 ("GATT 1994") permits an importing country to levy antidumping duties on a product in addition to normal tariffs, if dumping of that product causes material injury to the producers of the like domestic product. The WTO Agreement on Implementation of Article VI of the GATT 1994 (often referred to as the "Anti-dumping Agreement" or "ADA") provides disciplines limiting anti-dumping measures.

[19] The GPA is not part of the WTO's single undertaking, but is one of the plurilateral agreements to which not all WTO members are a party. China, for example, is not currently a party to the GPA, but is in the process of negotiating its accession.

[20] Interestingly, the bill does not say which WTO rules it would expect to be violated by the type of governmental measures that lead to the designation of a currency "for priority action" in the first place.

[21] *See generally* Robert W. Staiger & Alan O. Sykes, *Currency Manipulation and World Trade* (Nat'l Bureau of Econ. Research, Working Paper No. 14600), *available at* http://www.nber.org/papers/w14600.

[22] CVDs are imposed on imports of a product to offset subsidies if subsidized imports of that product cause material injury to the domestic industry producing the like product. CVDs are permitted by Article VI of the GATT 1994 and the WTO Agreement on Subsidies and Countervailing Measures, but are subject to strict legal limits.

[23] CVD proceedings on Certain Coated Paper Suitable for High-Quality Print Graphics Using Sheet-Fed Presses from the People's Republic of China, 75 Fed. Reg. 10,774 (Mar. 9, 2010), *available at* http://ia.ita.doc.gov /frn/2010/1003frn/2010-5007.txt (noting that the final determination is due July 12); Aluminum Extrusions from the People's Republic of China, 75 Fed. Reg. 22,144 (Apr. 27, 2010), *available at* http://ia.ita.doc.gov/frn/2010 /1004frn/2010-9742.txt.

[24] The Plaza Agreement, or Plaza Accord, was an agreement between France, Japan, United Kingdom, the United States, and then West Germany, to intervene in currency markets to bring about an appreciation of the Japanese Yen and the Deutsche Mark in relation to the USD. It was signed on September 22, 1985, at the Plaza Hotel in New York City; hence its name.