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A CASE FOR MISALIGNED CURRENCIES AS COUNTERVAILABLE SUBSIDIES

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A CASE FOR MISALIGNED CURRENCIES AS COUNTERVAILABLE SUBSIDIES

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Abstract

Artificially undervalued currencies are giving an unfair competitive advantage to some WTO Members, nullifying the trade protections of other WTO Members and undermining the predictability and credibility of WTO rules. A threshold dividing legal and illegal devaluations, from the Agreement on Subsidies and Countervailing Measures (ASCM) standpoint, must be drawn to address this issue. This paper argues that such threshold is exceeded when a WTO Member's measures undervalue its currency far below an equilibrium level and for more than the time needed to address economic imbalances. In this scenario, an artificially undervalued currency may amount to a countervailable subsidy actionable under the ASCM

Introduction

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This paper claims that both the General Agreement on Tariffs and Trade ("GATT") and the Agreement on Subsidies and Countervailing Measures ("ASCM") allow World Trade Organization ("WTO") Members to initiate investigations and, ultimately, categorize as countervailable subsidies the measures that other WTO Members have taken to keep the value of their currencies far below an equilibrium level for more than the time needed to face economic imbalances.[4] If this trade remedy were not allowed, misaligned currencies might continue not only limiting the levels of market access that WTO Members have agreed to but also undermining the credibility and predictability of WTO rules.[5] Even worse, it would increase the likelihood and devastating impact of undesirable competitive devaluations and currency wars.[6]

A key issue is which is the deviation from the equilibrium level and the duration of governmental measures that would make an undervalued currency a countervailable subsidy. Not surprisingly, drawing the line that divides lawful and unlawful devaluations, from the ASCM standpoint, is complex.[7] Yet, complexity is not a reason to postpone this

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[4] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, Impacts of Exchange Rates on International Trade Policy Instruments: The Case of Tariffs, unpublished manuscript available at: http://www.imd.org/research/centers/eviangroup/upload/2127-2.pdf (2011), at 17, 27 (stating that only misalignments surpassing a red border from where the level of market access is affected and the trade policy instruments are nullified are in breach of the WTO rules). The unpublished version of this manuscript in Portuguese is available at: http://www.ipea.gov.br/portal/images/stories/PDFs/110822_nt004_dinte.pdf.

[5] This paper uses the terms: (1) currencies that are kept artificially low, (2) artificially undervalued currencies, (3) misaligned currencies, and (4) competitive devaluations as interchangeable. They mean currencies that have been significantly deviated from its equilibrium value for more than the time needed to address economic imbalances.

[6] See The Global Economy, How to Stop a Currency War, The Economist (Oct. 14, 2010). Available at: http://www.economist.com/node/17251850 (last visited Feb. 13, 2012) This article refers to a declaration on 27 Sept. 2010 from Brazil's finance minister, Guido Mantega, according to which an international currency war had broken out.

[7] An unlawful devaluation, for the purpose of this paper, means a devaluation amounting to a subsidy in accordance with WTO rules, and not a devaluation that may or may not be in breach of the Articles of Agreement of the International Monetary Fund.

task. Although a threshold must be determined in a case-by-case analysis, some guidelines exist.

First, the likelihood of considering an undervalued currency as a countervailable subsidy depends on the exchange rate system. Market shocks that depreciate a currency are not countervailable because legal action is only feasible when a WTO Member has taken a measure.[8] For this reason, currencies that freely float with the market will not be countervailable under the WTO rules. Other exchange rate systems will be more susceptible to be labeled as illegal subsidies. For instance, fixed exchange rates or currencies that are artificially pegged to another currency or to a basket of currencies. Currencies that are under a managed floating exchange rate regime lies somewhere in between: difficult but not impossible to challenge. They could be categorized as countervailable subsidies if the intervention is protracted and extreme, resulting in a significant deviation from the equilibrium level value. Such will be the case of a country that, lacking balance of payments' problems and whose gross domestic product is steadily growing, devalues its currency for an extended period of time. Otherwise, short-term interventions will be presumed as legal in the context of WTO rules.[9]

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[8] ASCM Art. 4.5.

[9] Short-term interventions will not be actionable for theoretical and practical reasons. A theoretical reason is that short-term interventions are less likely than long-term ones to cause adverse effects or material injury to WTO Members. The practical reason, in turn, is that an investigation intended to impose a countervailing duty will likely be finished after the short-term intervention has ended. An illustration of a short-term intervention, presumed as legal, is a sudden devaluation aimed at either adjusting the value of the currency after a period of unsustainable overvaluation or to check capital flights. See Claus D. Zimmerman, Exchange Rate Misalignment and International Law, 105, no. 3, The American Journal of International Law (2011), at 438.

Second, a threshold dividing lawful and unlawful devaluations, from the WTO rules standpoint, does not mean that the discretion that WTO Members have to manage their exchange rate regimes is curtailed. After all, the International Monetary Fund ("IMF") rules that bind countries to keep their exchange rates fixed or within predetermined narrow margins have not been in legal force since 1971.[10] Nowadays, and pursuant to the ASCM, only protracted and extended competitive devaluations in countries not facing macroeconomic problems will amount to countervailable subsidies.[11] Even in those cases, WTO Members might keep their autonomy to devalue their currencies by any percentage margin and for any length of time provided they bear the cost of such measure: the right that other WTO Members have to impose countervailing duties to their exports.

Finally, some GATT rules, other than those related to either exchange rates or subsidies, may be helpful to establish a threshold. For instance, GATT Art. XII:2(a), according to which a WTO Member is allowed to impose restrictions to safeguard its external financial position and its balance of payments but only to the extent needed to keep its monetary reserves at a reasonable level. Analogically, WTO Members may devalue their currencies to address economic imbalances but not to obtain an unfair competitive advantage. Such would be the case, for example, when there is no economic imbalance to correct.[12]

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[10] *See* Joseph Gold, Legal and International Aspects of the International Monetary System: Selected Essays, ed. Evensen, Jane B. & Oh, Jai Keun (Washington: International Monetary Fund, 1979), at 520.

[11] Some examples of macroeconomic problems are: (1) current account deficits, (2) other balance of payments problems, (3) economic recessions, and (4) financial crises, such as those that sudden flights of capitals might cause.

[12] Undeniable, any devaluation, regardless of its degree, causes and purposes, confers a competitive advantage. Nonetheless, only artificially undervalued currencies might confer an illegal competitive advantage in terms of the ASCM.

This paper does not target any particular WTO Member. This is a key difference with other papers on the same topic,[13] which focus on the Chinese currency, the yuan.[14] The reasons for having a general methodology are twofold. First, the case of China is the most important but not the only example of currency misalignment. Other countries have resorted or may resort in the future to this kind of measure.[15] Second, a general methodology is useful in order to prevent political issues from interfering with the focus on the legal and economic aspects of currency misalignments.

The structure of this paper is as follows. Section I reminds that devaluations have the same economic effect that an across-the-board tariff-cum-subsidy. Section II discusses the requirements that a WTO Member, which intends to categorize a misaligned currency as a subsidy, must fulfill. Section III analyzes the scenario in which a countervailing subsidy is challenged before the WTO. Section IV makes some concluding remarks.

Section I – Economics of currency misalignments

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[13] See, among other papers: (1) Dukgeun Ahn, Is the Chinese Exchange-rate Regime "WTO-legal"?, in The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, ed. Simon Evenett (London: Center for Economic Policy Research, 2010): 139-145; (2) Benjamin Blase Caryl, Is China Currency Regime a Countervailable Subsidy? A Legal Analysis Under the World Trade Organization's SCM Agreement, 45, no. 1 Journal of World Trade (2011):187-219; (3) Nathan Fudge, Walter Mitty and the Dragon: An Analysis of the Possibility for WTO or IMF Action against China's Manipulation of the Yuan, 45, no. 2 Journal of World Trade (2011): 349-373; (4) John Magnus & Timothy C. Brightbill, China's Currency Regime is Legitimately Challengeable as a Subsidy Under ASCM Rules, in The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, ed. Simon Evenett (London: Center for Economic Policy Research, 2010): 147-152; and (5) Joel P. Trachtman, Yuan to Fight About It? The WTO Legality of China's Exchange Regime, in The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, ed. Simon Evenett (London: Center for Economic Policy Research, 2010): 127-131.

[14] The International Monetary Fund refers to the Chinese currency as the yuan. *See* International Monetary Fund webpage: *http://www.imf.org/external/np/fin/data/rms_five.aspx* (last visited 27 Feb. 2012). But see Caryl, *supra* note 8, at 188 n. 2 ("China's currency is called the 'renminbi ('the People's Money') while 'yuan' is the name of the basis unit (similar to 'dollar' in the United States.").

[15] See Claus D. Zimmerman, supra note 6, at 423..

It is a long established principle of economics that a devaluation amounts to a uniform tariff-cum-subsidy. In 1931, John Maynard Keynes said that a combination of subsidies and tariffs has an impact equivalent to a devaluation.[16] The passage of time has not changed this simple but relevant conclusion. In 1967, Gottfried Haberler reminded that the combination of an uniform tax on imports and subsidies on exports was a close substitute for currency devaluations.[17] More recently, in 2011, Emmanuel Farhhi, Gita Gopinath & Oleg Itskhoki showed that the effect of devaluations can be mimicked through fiscal instruments, such as an uniform increase in import tariffs and export subsidies and an increase in some internal taxes (e.g., the value added tax and the income tax).[18]

Thus, the economic effect of devaluations is twofold. On the one hand, an undervalued currency grants increased protection to domestically produced goods because imports become more expensive.[19] On the other hand, a devaluation, *ceteris paribus*, increases the price competitiveness of exports by lowering their price in foreign currency while keeping the price in domestic currency unchanged.

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[16] See John S. Chipman, Protection and Exchange Rates in a Small Open Economy, 11, no. 2, Review of Development Economics (2007), at 205. Chipman quotes Keynes as follows: "Precisely the same effects as those produced by a devaluation of sterling by a given percentage could be brought about by a tariff of the same percentage on all imports together with an equal subsidy on all exports, except that this measure would leave sterling international obligations unchanged in terms of gold."

[17] See Gottfried Haberler, Import Taxes and Export Subsidies A Substitute for the Realignment of Exchange Rates, Kyklos International Review for Social Sciences, 20, no. 1 (1967), at 17.

[18] See Emmanuel Farhi, Gita Gopinath & Oleg Itskhoki, supra note 8, at 1.

[19] This paper will not analyze the legal aspects of this effect (i.e., whether artificial undervalued currencies may give rise to antidumping investigations).

The scenario in countries whose currencies are overvalued is the opposite. There, local producers are harmed due to a lower level of protection against imports. Although the nominal level of actual and bound tariffs remains unchanged, the real level is lower or even negative.[20] Vera Thorstensen, Emerson Marçal & Lucas Ferraz calculate that a U.S. dollar's 10% devaluation will decrease Brazil's bound rates from their actual levels (12% to 50%) to a range from 0% to 35%. In turn, a 20% devaluation of the Chinese yuan will reduce the real bound rates to a range from -10% to 19%.[21] Those figures show that due to currency misalignments, real bound tariffs might not only have a limited effect as legal trade barriers but also, in the case of negative real bound rates, be a subsidy to imports.[22] More generally, excessive currency misalignments may distort the role of transparent and predictable tariffs as the single legal instrument to protect domestic markets and affect the checks and balances of the world trading system (i.e., the benefits and obligations that countries have bargained for in several rounds of negotiations).

This pessimistic (but realistic) scenario is even gloomier for countries which cannot devalue on an individual basis because of its membership to a currency union, such as the Euro zone. These countries are in the worst of all worlds, at least from an international trade standpoint. They are not allowed to raise tariffs above the levels agreed to in their schedule of concessions, grant subsidies that are in breach of the ASCM, nor devalue their currency without a collective action through their monetary union. However, they

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[20] Pursuant to GATT Art. II(1)(b) WTO Members have to keep their applied tariffs in equal or lower levels than their bound tariffs.

[21] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, supra note 5, at 7-10.

[22] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, supra note 5, at 28.

must suffer the harm that artificially undervalued currencies of other WTO Members cause without receiving trade concessions in exchange. Extreme solutions to this asymmetry among WTO Members, such as some of those countries abandoning their currency unions, are not needed. A simpler solution is the imposition of countervailing duties against products from countries whose currencies are artificially undervalued.

Admittedly, the harmful effects of devaluations may be offset if prices in the country that undervalues its currency adjust upwards while prices in other countries adjust downwards.[23] However, these adjustments will only take place if markets work in perfect competition and, as a result, prices are fully flexible. This could happen in ideal markets but rarely, if not ever, in real markets, most of which have failures such as sticky prices. In any case, arguing *arguendo* that the effect of devaluations will disappear in the long-term, does not quell the harm that WTO Members will suffer in the meantime and that may be devastating for the world trading system. As John Maynard Keynes put it when he was still alive: "In the long-run, we are all dead."[24]

In light of the economic rationale indicated before, WTO Members might circumvent the prohibition to raise tariffs above their bound levels or to grant subsidies prohibited under the ASCM by devaluing their currencies. Indeed, WTO Members are allowed to devalue but their freedom is not absolute, at least from the ASCM standpoint. Devaluations are a medicine that sick countries may self-prescribe but not overuse. The

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[23] See Robert W. Staiger & Alan O. Sykes, Currency 'Manipulation' and World Trade: a Caution, in The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, ed. Simon Evenett (London: Center for Economic Policy Research, 2010), at 110.

[24] John Maynard Keynes, A Tract on Monetary Reform (London: Macmillan, 1924), at 65.

limit to this freedom is the extent to which a devaluation is needed as a policy instrument to face economic imbalances. If this limit is surpassed, the multilateral trade agreements will amount to innocuous rules that prohibit one method to gain unfair competitive advantages (a tariff-cum-subsidy) and, simultaneously, approve another method that has the same economic effect (an artificial devaluation).

Section II – Misaligned Currencies as Countervailable Subsidies

Section I reminded that a devaluation has the same economic effect that an uniform tariff on imports plus a subsidy on exports. Section II contends that misaligned currencies may also be a countervailable subsidy on exports from a legal standpoint.[25]

A WTO Member that intends to challenge a misaligned currency as a subsidy has two different but not exclusive options. This paper focuses on the first and defensive option, which is to impose countervailing duties on the products from the devaluing country. The country whose misaligned currency led to this action may in turn challenge those

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[25] Misaligned currencies may also be in breach of WTO rules other than the ASCM. For instance, an artificially undervalued currency may be in breach of GATT Art. II(1)(b), according to which a WTO Member cannot impose duties or charges in excess of its bound tariffs. As indicated in Section I, an undervalued currency makes imports more expensive. If this effect is tariffied, actual rates may be higher than bound rates. Since no WTO Member has committed to a specific currency regime in its schedule of concessions, an artificially undervalued currency, acting as a duty on top of the applied rates, is not a de jure violation. Nonetheless, it may be a de facto violation. In addition, whether or not WTO rules are actually breached, a misaligned currency might give rise to a non-violation nullification or impairment claim in accordance with GATT Art. XXIII:1(b). In this sense, a WTO Member who imports goods from a country whose currency is artificially undervalued may have a reduced level of protection. As also indicated in Section I, its actual and bound rates, while unchanged in nominal terms, are lower in real terms. The Appellate Body has said that a non-violation claim is an exceptional cause of action which should be used with caution and only if the following four elements are proved: (1) A WTO Member has applied a measure (e.g., it has artificially undervalued its currency); (2) another WTO Member has a benefit accruing under a WTO agreement (e.g., the bound tariffs agreed in the schedule of concessions); (3) the expectations of a benefit are legitimate (e.g., they are in accordance with GATT 1994 and other WTO rules); and (4) there is a nullification or impairment of the benefit as a result of the application of the measure (e.g., the bound rates are ineffective as a trade protection against imports coming from a country whose currency is misaligned). See Panel Report, *Japan-Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/$ (adopted 31 Mar. 1998), paras. 10.41 and 10.76.

countervailing duties before the WTO. The second and offensive option is to challenge the subsidy directly before the WTO. [26]

A WTO Member that chooses the route of imposing countervailing duties shall determine that the investigated misaligned currency amounts to a subsidy from a legal point of view. Two WTO rules provide a definition of subsidy: GATT Art. XVI and the ASCM Art. 1. GATT Art. XVI defines subsidies as follows: "Subsidies are measures that directly or indirectly result in the sale of an exported product for less than the price for buyers on the comparable domestic market." Generally speaking, governmental measures that keep a currency at an artificial low level result, directly or indirectly, all other things being equal, in exports whose price in any foreign currency is less than the price in the domestic market. Therefore, misaligned currencies may meet the definition of subsidy under GATT Art. XVI. Still, a misaligned currency meeting this definition is not enough, especially considering that while GATT Art. XVI has not been technically repealed, the ASCM might have superseded it. Thus, misaligned currencies shall also meet the definition of subsidy under ASCM Art. 1.

In accordance with the definition of ASCM Art. 1, a subsidy shall be deemed to exist if: (1) there is a financial contribution[27] or any form of income or price support;[28] and (2)

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[26] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 67. See also see Benjamin Blase Caryl, supra note 8, at 191 (mentioning that challenging a misaligned currency before the WTO would require many more resources and time than conducting a domestic investigation intended to impose countervailing duties). While this statement may be true, a WTO Member cannot impose a countervailing duty based on simple assertions and without any economic and legal analysis. A serious, data-intensive and complex investigation in accordance with the ASCM and the domestic rules is required.

[27] ASCM Art. 1.1(a)(1).

[28] ASCM Art. 1.1(a)(2).

a benefit is conferred.[29] Also, a WTO Member can only impose countervailing measures against (3) subsidies that are deemed specific.[30] Each of these three elements are discussed below with respect to misaligned currencies.[31]

A. Financial contribution or any form of income or price support

1. Financial contribution

ASCM Art. 1.1(a) mentions four types of financial contributions. Misaligned currencies may fit at least the first and fourth categories.[32]

a. ASCM Art. 1.1(a)(i): A government practice involving a direct transfer of funds or potential direct transfer of funds or liabilities

Governmental measures that keep a currency at an artificial low level generate a transfer of funds because the amount in local currency that exporters receive in exchange for their proceeds in any foreign currency is higher than the units that they would have obtained if the exchange rate were not misaligned. Put more simply, the government is paying the exporters an extra price or a bonus for the international reserves that they are exchanging into local currency. The more the local currency is undervalued, the more

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[29] ASCM Art. 1.1(b).

[30] ASCM Art. 1.2, 2, and Part. V.

[31] Pursuant to ASCM Art. 11.2, an investigation initiated to impose countervailing measures shall also prove both injury and a causal link between the exports that an artificially undervalued currency is subsidizing and this injury. Since the legal rules related to injury are the same for all subsidies and its analysis heavily depend on the particular circumstances of the industries and countries involved in a countervailing investigation, this paper will not elaborate on the those matters.

[32] See Benjamin Blase Caryl, supra note 8, at 200 (affirming that the first category – a direct transfer of funds – has the best chances to succeed as a financial contribution before a panel). See also *Id.*, at 195 (showing that the jurisprudence of WTO panels shows that ASCM Art. 1.1(a)(1) paras. (i) to (iv) may cover a wide range of governmental measures). But see Debra P. Steger, Professor of the Faculty of Law, University of Ottawa, Canada; who reminded that ASCM Art. 1.1(a)(1) paras. (i) to (iv) is a closed list in an e-mail addressed to the authors of this paper (e-mail on file with the authors).

extra money exporters receive and the government gives away (and perhaps, print, adding to the cost of inflation).[33] This rationale has been labeled as simplistic.[34] Yet, by clearly explaining how the transfer of funds takes place, simplicity here is strength rather than a weakness.

Hence, a transfer of funds exists. Still, this is not enough. The transfer of funds must be direct. Sometimes, this requirement will not be met, as happens when a government, as another agent in the financial market, buys bonds denominated in foreign currency to increase the supply of local currency. As another illustration, fiscal measures, even those intended more to devalue the local currency than to raise revenues, do not amount to a direct transfer of funds. This will be the case of a tax on some financial transactions, such as loans granted by foreign banks, levied to disincentivize the inflow of foreign currencies. Likewise, if the market, and not the government, is the force behind a currency's depreciation neither a governmental measure nor a financial contribution will exist.[35]

Conversely, the transfer of funds will be direct when the laws or regulations require exporters and other holders of foreign currencies to exchange them for local currency at levels not based on market considerations. Similarly, measures imposing a dual foreign exchange regime, with a preferential exchange rate for exporters and a

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[33] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 9 and 46 (affirming that as long as exporters receive an extra amount of domestic currency, the requirement of financial contribution is fulfilled.

[34] See Claus D. Zimmerman, supra note 6, at 448, note 115.

[35] See Catharina E. Koops, Manipulating the WTO? The Possibilities for Challenging Undervalued Currencies Under WTO Rules, 2010 Research Paper Series, Amsterdam Center for International Law, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1564093 (2010), at 3 (stating that a financial contribution has to be a measure that the government or any public body has implemented).

general exchange rate for other holders of foreign currency, will amount to a direct transfer of funds.[36] Those are not the only illustrations of a direct transfer of funds regarding misaligned currencies. A WTO Member intending to keep its currency at an artificial low level might devise other financial strategies and legal rules to achieve this purpose. Whether such rules amount to a direct transfer of funds can only be established on a case-by-case basis. The national authorities of other WTO Members will have the competence to make this analysis in a first step, in order to determine if countervailing duties can be imposed. In a second step, if such duties are challenged before the WTO, a panel and the Appellate Body will make the final analysis.

b. ASCM Art. 1.1.(a)(ii): A government revenue that is otherwise due is foregone or not collected

A government which buys foreign currencies at an artificially undervalued exchange rate incurs in an extra cost. However, this transaction does not amount to a government revenue that is foregone or not collected.[37] One thing is selling local currency at a cheap price (this happens when the local currency is undervalued) and another thing is selling the same currency and, before collecting (the foreign currency), waiving this right. No country will be so naïve or financially reckless to do that. Indeed,

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[36] The Chinese regime that was in legal force between 1988 and 1993 is an example of a dual exchange rate system. This regime ended on 1 Jan. 1994, when the official rate (at this time, 5.8 yuans per U.S. dollar) and the market rate (at this time, 8.7 yuans per U.S. dollar) were unified. Under this regime, some companies, such as exporters, exchanged their foreign currencies at the market rate in the so-called swap markets, which accounted for up to 80% of the transactions in foreign exchange. See Tao Wang, China: Sources of Real Exchange Rate Fluctuations, IMF Working Paper WP/04/18, Asian and Pacific Department (2004): 1-22. See also Yi Gang, Renminbi Exchange Rates and Relevant Institutional Factors 28 No. 2 Cato Journal (2008): 187-196.

[37] See Claus D. Zimmerman, supra note 6, at 448 (concluding than the overpayment of local currency is not a governmental revenue that is forgone).

the existence of this kind of financial contribution is unheard of in disputes regarding exchange rates while common in measures granting tax credits or other fiscal incentives.[38] For instance, a law cancelling the outstanding tax debts of exporters will be a government revenue that is foregone. In light of the above, a misaligned currency is not a financial contribution in accordance with ASCM Art. 1.1.(a)(ii). But this is not an issue for a country which intends to impose countervailing duties since a misaligned currency might be a financial contribution as a direct transfer of funds.

c. ASCM Art. 1.1.(a)(iii): A government provides goods or services other than general infrastructure, or purchases goods

A government that gives local currency in exchange for any foreign currency is not providing any good. While goods is a broad category, it does not include money.[39] Hence, an artificially undervalued currency will only be a financial contribution in accordance with ASCM Art. 1.1.(a)(iii) if the government is providing a service. Perhaps, a government that fixes its currency's exchange rate or pegs it to another currency is rendering a free hedging service to exporters, who do not need to spend money in private capital markets in order to protect against currency fluctuations. [40] This service will comply with the condition of being different from general infrastructure because only exporters, tourists, foreign investors and other holders of foreign currencies will obtain a

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[38] E.g., Appellate Body Report, *United States – Tax Treatment for 'Foreign Sales Corporations'*, WT/DS/108/AB/R (adopted 20 Mar. 2000), paras. 89-92. See also Benjamin Blase Caryl, supra note 8, at 198.

[39] See Panel Report, *United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R (adopted 1 Nov. 2002), paras. 7.22-7.23. See also Benjamin Blase Caryl, supra note 8, at 196.

[40] See Benjamin Blase Caryl, supra note 8, at 196-97 and Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 47.

benefit.[41] However, the fact that hedging is a byproduct but not the main goal of governmental measures that keep a currency at an artificial low level makes it unlikely that another government finds a financial contribution under SCM Art. 1.1.(a)(iii). Again, this is not a big issue for a country intending to impose countervailing duties since a financial contribution may be present under SCM Art. 1.1.(a)(i) – a direct transfer of funds.

d. ASCM Art. 1.1.(a)(iv): A government makes payments to a funding mechanism, or entrust or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments

ASCM Art. 1.1.(a)(iv), drafted to avoid circumvention of ASCM Art. 1.1.(a)(i) to (iii), will be applicable when a government has made a financial contribution (e.g., a direct transfer of funds) through one or more private entities. In the case of misaligned currencies, the private entities might be banks that, acting as governmental agents without any real autonomy, exchange any foreign currency for the domestic currency at the rate that the government has fixed.[42] It could also happen that a dual foreign exchange regime exists, i.e., a preferential rate for exporters and a general or market rate for other holders

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[41] The Panel in EC-Aircraft said that general infrastructure "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." Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R (adopted 30 Jun. 2010), paras. 7.1015-1044. See also Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 48.

[42] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 45-46 and Benjamin Blase Caryl, supra note 8, at 197-98.

of foreign currency, and that the government binds itself to compensate private banks for the discount from the general rate that they are giving to exporters.

All the five elements required here might be present in misaligned currencies kept at artificial low levels for more than the time needed to face macroeconomic problems: (1) a government entrusts or directs; (2) a private body; (3) to carry out one or more of the type of functions illustrated in Art. 1.1.(a)(i) to (iii); (4) which would normally be vested in the government; and (5) the practice, in no real sense, differs from the practice normally followed by governments.[43]

In summary, a misaligned currency might be a financial contribution either as a direct transfer of funds (ASCM Art. 1.1.(a)(i)) or as payments that a government makes through private banks (ASCM Art. 1.1.(a)(iv)). In turn, while a misaligned currency might entail a service of hedging, it is unlikely that this will amount to a financial contribution (ASCM Art. 1.1.(a)(iii)). Finally, a misaligned currency is not a financial contribution under ASCM Art. 1.1.(a(ii) because buying local currency at a low price does not amount to a government revenue that is foregone or not collected after it is due.

2. ASCM Art. 1.2 There is any form of income or price support in the sense of GATT Art. XVI

Pursuant to GATT Art. XVI:1, an income or price support "operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory." GATT Art. XVI:1 has not been tested in any WTO dispute related to

[43] Panel Report, United States – Tax Treatment for 'Foreign Sales Corporations', WT/DS/108/AB/R (adopted 20 Mar. 2000), para. 8.25. See also Benjamin Blase Caryl, supra note 8, at 197-98.

subsidies. At least one author says that it would be unlikely that a panel would exclusively rely on this factor to hold that a misaligned currency is either a financial contribution or any form of income or price support.[44] However, the lack of jurisprudence with respect to subsidies does not imply that this factor is without legal support. Furthermore, some jurisprudence about the Agreement on Agriculture may serve as guidance. The Appellate Body has held that an income or price support exists when a government buys domestic agricultural goods at high prices that do not bear relation to world market prices.[45] This analysis can be extended to currency misalignments: an income or price support is present when a WTO Member buys foreign currencies at high prices regardless of market prices (either theoretical or real). Thus, assume for the sake of argument that governmental measures that have artificially undervalued a currency are specific and grant a benefit but do not amount to a financial contribution. In this case, these measures will be a subsidy because there is a form of income or price support.

B. Benefit

The notion of benefit encompasses some form of advantage.[46] More specifically, a benefit exists when a governmental measure "makes the recipient 'better off' than it

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[44] See Benjamin Blase Caryl, supra note 8, at 200.

[45] See, e.g., European Communities – Customs Classification of Certain Computer Equipment, WT/DS269/ AB/R, WT/DS286/AB/R (adopted 27 Sep. 2005); Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, WT/DS103/AB/R (adopted 27 Oct. 1999); Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WT/DS161/AB/R (adopted 10 Jan. 2001). See also Benjamin Blase Caryl, supra note 8, at 199, note 57. Claus D. Zimmerman, supra note 6, at 449.

[46] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* , as modified by Appellate Body Report WT/DS70/AB/R WT/DS70/R (adopted 20 Aug. 1999), para. 9.112.

would otherwise have been, absent that contribution."[47] In the case of currencies, governmental measures intended to keep them at artificially low levels make exporters better off in comparison with a scenario in which the exchange rate is close to its equilibrium value. Therefore, a misaligned currency benefits exporters.

The precise nature and extent of the benefit depends on the type of financial contribution.[48] If the financial contribution is a governmental service allowing exporters to protect against market fluctuations, the benefit is the value of the hedging service in the financial markets. In the more plausible scenario in which the financial contribution is a direct transfer of funds (or if there is any form of income or price support), the benefit is twofold. On the one hand, the units of the local currency that exporters receive for each unit of foreign currency that is exchanged outweighs the units that they would have received if the exchange rate were close to its equilibrium value. On the other hand, an undervalued currency allows exporters to reduce the price of their exports in foreign currencies and, consequently, increase the number of goods sold in foreign markets.

Regarding misaligned currencies, the benefit is the least controversial element among scholars.[49] This is not to say that this matter is completely settled. For instance, Robert W.

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[47] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (adopted 20 Aug. 1999), para. 157. See also Benjamin Blase Caryl, supra note 8, at 201.

[48] Benjamin Blase Caryl, supra note 8, at 201.

[49] E.g., Nathan Fudge says that finding a benefit is not a problem. Nathan Fudge, Walter Mitty and the Dragon: An Analysis of the Possibility for WTO or IMF Action against China's Manipulation of the Yuan, 45, no. 2 Journal of World Trade (2011), at 352..

Staiger & Alan O. Sykes say that any benefit may not be readily conferred if prices rise.[50] Yet, as indicated in Section I, this adjustment will only occur in perfect markets and in the long-term. In the interim, exporters might have accrued huge profits and caused material injury to one or several WTO members. It is also said that exporters using their sales proceeds to buy inputs abroad or invest in financial instruments denominated in foreign currencies does not receive any benefit. This may be true; though, other exporters, those exchanging their profits in foreign currencies for local currency, do receive a benefit. Furthermore, a highly undervalued currency makes it more profitable to convert foreign currencies into domestic currency than to keep the money abroad provided that domestic inflation and taxes, but not real interest rates, are relatively low. A third criticism, which says that actors other than exporters (e.g., tourists and foreign investors) receive the benefits of an undervalued currency, will be rebutted in the analysis of specificity.[51]

In light of the above, a benefit exists in the case of misaligned currencies. Yet, one question remains: how to quantify the benefit? Quantification is required to set the amount of the countervailing duties. As a general answer, the benefit per unit of foreign currency amounts to the difference between the undervalued exchange rate and the equilibrium exchange rate. Unfortunately, this answer raises another question: which should be the equilibrium rate? Most of the time, neither a domestic nor an international

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[50] See Robert W. Staiger & Alan O. Sykes, Currency Manipulation and World Trade, SSRN Working Paper, June 13, 2008. See also Dukgeun, Is the Chinese Exchange-rate Regime "WTO-legal"?, in The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, ed. Simon Evenett (London: Center for Economic Policy Research, 2010), at 142. (stating that a benefit may not occur if market prices tend to adjust to exchange rate regimes).

[51] *See* § II.C *infra.*

comparison is possible because an artificially undervalued currency that is fixed or pegged to another currency has the same exchange rate everywhere. The alternative is to compare the undervalued exchange rate with an estimated equilibrium rate.

The jurisprudence of the WTO has approved the use of constructed or proxy market rates. In *U.S.-Softwood Lumber IV*, the Appellate Body said that, in order to measure a benefit, WTO Members have "the possibility to select any method that is in conformity with the 'guidelines' set out in Article 14 [of the ASCM]." [52] Those guidelines do not appear to restrict the possibility of using an equilibrium exchange rate.

In turn, in *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China*, the U.S. Department of Commerce estimated the benefit resulting from loans that state-owned commercial banks made to some Chinese enterprises using a proxy interest rate instead of Chinese actual interest rates. On the assumption that an inverse relationship existed between income levels and lending rates, the proxy interest was estimated through a regression analysis of inflation-adjusted interest rates in thirty lower-middle-income countries.[53] The Panel held that the use of a proxy interest rate was in accordance with ASCM Art. 14(b).[54] The Appellate Body confirmed this finding and affirmed that ASCM Art. 14(b) entitled the domestic authority, the U.S. Department of

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[52] See Appellate Body Report, *United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber from Canada (US – Softwood Lumber IV)*, WT/DS257/AB/R (adopted 17 Feb. 2004) para. 91. See also Benjamin Blase Caryl, supra note 8, at 203-04.

[53] Panel Report, *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China* , WT/DS379/R (adopted 22 Oct. 2010), paras. 10.193.

[54] Panel Report, *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China* , WT/DS379/R (adopted 22 Oct. 2010), paras. 10.117 ("Article 14(b), by its own terms, makes allowance for the use of proxies when an identical or nearly-identical loan is not available as a benchmark") and 10.119 ("If no appropriate commercial loan benchmark can be identified, then the authority could construct a benchmark loan proxy."). See also Benjamin Blase Caryl, supra note 8, at 204.

Commerce, to reject interest rates in China if they were distorted and resort to an external benchmark.[55]

Admittedly, the Appellate Body rejected the standard of review of the Panel according to which a domestic authority may use any econometric methodology that is appropriate and not unreasonable and held that a panel shall engage in a critical and rigorous review of whether the constructed proxy is justified in light of alternative proxies.[56] However, this was a criticism of the review by the Panel on the methodology that the U.S. Department of Commerce used and not a denial of the right to use a proxy interest rate. Thus, the Appellate Body did not object to the use of econometric methodologies to calculate the benefit that a subsidy grants.

There are several econometric methodologies to calculate the equilibrium exchange rate of a currency. A traditional methodology is the purchase power parity, which estimates the real exchange rate as a function of the difference between the prices of goods in the domestic and foreign markets.[57] International organizations have developed more sophisticated techniques. For instance, the IMF has the following three methodologies: a macroeconomic balance approach, a reduced-form equilibrium real

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[55] Appellate Body Report, *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (adopted 11 Mar. 2011), para. 535.

[56] Panel Report, *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China* , WT/DS379/R (adopted 22 Oct. 2010), paras 10.204-10.209. and Appellate Body Report, *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (adopted 11 Mar. 2011), paras. 519 to 527.

[57] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, supra note 5, at 20.

exchange rate approach, and an external sustainability approach.[58] In turn, some think tanks, such as the Peterson Institute, have devised other methodologies.[59]

Estimating the difference between an exchange rate and its equilibrium value is part of the task of calculating countervailing duties Another part is estimating the injury that an increase of subsidized imports is causing to the domestic industry.[60] This injury quantification, and the countervailing duties themselves, can also be calculated using econometric methodologies as tools.[61] Indeed, the concept of tariffication is at the core of the WTO system. Many rules and bound tariffs were agreed after protracted negotiations and estimations of their effects in world trade. Furthermore, the essence of countervailing duties and antidumping measures is to compensate the effect of unlawful trade actions via tariffs.[62]

At least two criticisms are made to the econometric methodologies intended to estimate both the equilibrium value of an exchange rate and the amount of injury: that its

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[58] The first methodology calculates the market exchange rate in the long-term as a function of the equilibrium current account balance. The second methodology estimates an equilibrium real exchange rate as a function of medium-term fundamentals such as the net foreign asset position of a country, the relative productivity of the tradable and nontradable sectors, and the terms of trade. The third methodology calculates the adjustment in the exchange rate as a function of the difference between the actual current account balance of a country and the balance that would stabilize its net foreign assets position at some level that assumes a medium-term growth rate. See International Monetary Fund, Research Department (in consultation with the Policy Development and Review Department), Methodology for CGER Exchange Rate Assessments, available at: http://www.imf.org/external/np/pp/eng/2006/110806.pdf (2011).

[59] E.g., William R. Cline & John H. Williamson, Estimates of Fundamental Equilibrium Exchange Rates, Peterson Institute (2011) (explaining the methodology to calculate the so-called fundamental equilibrium exchange rate –FEER-, which is the exchange rate that allows a country to indefinitely maintain a determined deficit or surplus in its current account that match its underlying capital flows).

[60] See supra note 31, indicating that the main focus of this paper is neither on the legal rules on injury nor on its calculation.

[61] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, supra note 5, at 6 ("It is possible to develop a methodology to analyze the effect of exchange rate misalignments on either bound tariffs negotiated by a country as a compromised ceiling for the tariff of each product, or on applied tariffs.").

[62] *Id.*, at 7.

use in a domestic investigation or in a dispute before the WTO will be too complex and that it is unclear which of the available methodologies should be applied.

With respect to the first criticism, it is true that the estimation of both an equilibrium exchange rate and the amount of the countervailing duties may be a complex and data-intensive task. However, complexity is neither an insurmountable hurdle nor a reason to nullify the rights that WTO Members have to countervail illegal subsidies. This hurdle might have been intractable some decades ago, but not nowadays, when software and experts to run and use econometric methodologies are plentiful.

Likewise, the difficulty of measuring a benefit is neither exclusive of misaligned currencies nor of subsidies. Considerable issues usually arise with respect to quantifying the effect of, for example, unfair trade practices in trade remedy investigations involving non-market economies. *U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China*, a dispute related not only to countervailing duties but also to antidumping duties, is an example. There, the Appellate Body did not object to the use of econometric methodologies to calculate a benchmark interest rate provided that they comply with ASCM Art. 14(b).,[63] Similarly, complexity has been more the rule than the exception in the assessment of trade barriers such as tariff-rate-quotas (TRQs) and specific tariffs.[64]

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[63] See supra p. 20. See also Appellate Body Report, U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R (adopted 11 Mar. 2011), paras. 535. An illustration of a dispute exclusively focusing on antidumping duties is the Panel Report, European Union — Anti-Dumping Measures on Certain Footwear from China, WT/DS405/R (adopted 22 Feb. 2012).

[64] E.g., Appellate Body Report, European Communities — Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (adopted 25 Sept. 1997).

The second criticism states that it is not clear which of the available methodologies might be used. This paper contends that the national authority has enough discretion to use any econometric methodology in a domestic investigation intended to impose countervailing duties provided that it is technically sound, with data from authoritative sources when available, and appropriate to estimate an equilibrium exchange rate (i.e., a robust methodology). However, a WTO Member should not unreasonably reject methodologies favorable to the country whose exports are in risk of being countervailed (e.g., methodologies whose results suggest that a currency under investigation is not significantly deviated from its equilibrium value).[65] On the other hand, a WTO Member challenging countervailing duties before the WTO is allowed to demonstrate flaws in the methodologies that the respondent country applied in light of alternative, strong methodologies.[66] In this case, a panel and the Appellate Body will have the last say.

In this connection, the fact that different methodologies may produce different results is not bad. The higher the number of methodologies, the more the evidence about both the degree of misalignment of a currency in comparison with its equilibrium value and the amount of the countervailing duties. Naturally, if some methodologies indicate that a currency is not highly undervalued while other methodologies suggest the opposite, it would be within the national investigating authority's discretion to choose the most

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[65] See Appellate Body Report, U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R (adopted 11 Mar. 2011), paras. 519 to 527.

[66] See Appellate Body Report, U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R (adopted 11 Mar. 2011), paras. 525 to 527 (finding that the Panel should have engaged in a critical and searching analysis of the proxy interest rate that the U.S. Department of Commerce used in the light of plausible alternative explanations).

appropriate methodology, in line with its trade laws (assuming a WTO member country would have the ASCM provisions incorporated into its laws).

C. Specificity

A subsidy will be specific when it is either actionable under ASCM Art. 2.1 or prohibited under ASCM Art. 3.1. Actionable subsides are specific when they are granted to an enterprise or industry or a group of enterprises or industries. If an exchange rate is market-based and general for all entities, a misaligned currency will unlikely amount to an actionable subsidy because the criteria governing the access to the undervalued exchange rate will be objective and not exclusive for exporters. However, a subsidy might be actionable if some or all exporters may exchange foreign currencies at a preferential rate.

On the other hand, and pursuant to ASCM Art. 2.3 and 3.1, all prohibited subsides shall be deemed to be specific. A subsidy is prohibited when it is contingent upon export performance. The word contingent means "conditional" or "dependent for its existence on something else".[67] A prohibited subsidy may be contingent in law or in fact. Contingency in law is demonstrated on the basis of the words of legislation, regulation or other legal instruments.[68] Unless legislators or regulators are too naïve or obliged to enact a legal rule providing that exports are a condition to exchange foreign currency for local

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[67] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (adopted 20 Aug. 1999), para. 166.

[68] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (adopted 20 Aug. 1999), para. 167.

currency, an artificially undervalued currency will not be expressly contingent in law upon export performance.[69]

More likely, a currency that is kept at an artificially low level might be a subsidy contingent in fact upon export performance since companies will only obtain the benefit of extra units of local currency in exchange for any foreign currency if they export.[70] The Appellate Body has held that "satisfaction of the standard for determining de facto export contingency . . . requires proof of three different substantive elements: first, the 'granting of a subsidy'; second, 'is … tied to …'; and, third, 'actual or anticipated exportation or export earnings'."[71] A misaligned currency may comply with those three conditions and pass this test.

The fact that exporters are usually a group of enterprises comprising a diverse range of activities does not exclude specificity.[72] Likewise, the fact that an undervalued currency benefits not only exporters but also other groups such as tourists, foreign investors, and currency speculators does not eliminate its nature as a subsidy contingent in fact upon export performance.[73] According to the jurisprudence of the WTO, the fact

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[69] While it will be a rare event, a subsidy may be de jure export contingent without express words in the law if the connection between the exports and the subsidy is implied in the legal text. Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (adopted 20 Aug. 1999), para. 100. See also Benjamin Blase Caryl, supra note 8, at 209.

[70] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, para. 169.

[71] *Id.,* para. 169.

[72] Panel Report, U.S. – Definitive Antidumping and Countervailing Duties on Certain Products from China , WT/DS379/R paras 9-38-40 ("[W]e do not consider that the sheer diversity of economic activities supported by a given subsidy is sufficient by itself to preclude that subsidy from being specific."). An exception to this diversity of economic activities will be a country in which a single product accounts for most of its exports.

[73] Catharina E. Koops, supra note 34, at 6.

that the subsidies granted in a second set of circumstances (e.g., tourism or foreign investment) are not export contingent does not dissolve the export contingency arising in a first set of circumstances (e.g., exports).[74] In other words, the existence of export contingency must be determined for each category on its own (e.g., exports, tourism, foreign investment, etc.).

For the category of exporters, specificity will exist if the national authority of a WTO Member proves that an undervalued currency is tied to an increase in exports.[75] Econometric studies showing that the artificially low value of a currency, or the money that a government has spent to reduce such value, is correlated to an increase in the volume or price of exports might indicate the existence of this link. Of course, if the econometric study shows that the devaluation of a currency is not only correlated to but also causing a rise in exports, the evidence, and the case for specificity, will be stronger.

Summing up, government's measures that result in artificially undervalued currencies are specific subsidies contingent in fact upon export performance. To affirm otherwise, would be to excessively restrict the notion of specificity.[76]

Section III. - The Process before the World Trade Organization

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[74] Appellate Body Report, United States – Tax Treatment for Foreign Sales Corporations, Resource to Article 21.5 of the DSU by the European Communities, WT/DSBRO8/AB/RW (adopted 14 Jan. 2002), para. 119 While this case concerned tax issues, its rationale may be applicable to artificially undervalued currencies. See Nathan Fudge, supra note 47, at 358 and Benjamin Blase Caryl, supra note 8, at 209.

[75] *See* Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/ AB/R, para. 169 (holding that de facto export contingency requires evidence of the granting of a subsidy that is tied to actual or anticipated exportation or export earnings).

[76] See John Magnus & Timothy C. Brightbill, supra note 8, at 149 ("[T]he specificity test is only intended to avoid absurd results like countervailing the benefit arising from truly public goods provided by governments
(such as police protection and public highways).").

Section III discusses what happens if a WTO Member, whose currency is undervalued, challenges before the WTO the countervailing duties that another WTO Member has imposed. It has been said that the legal defense of countervailing duties in respect of misaligned currencies is a battle unlikely to succeed.[77] We disagree; some misaligned currencies may fulfill the requirements of financial contribution, benefit, and specificity and, as a result, the countervailing duties imposed may be defensible before the WTO.

It has also been argued that a legal dispute about the trade effects of misaligned currencies will be harmful for the claimant, the respondent and, specially, for the WTO.[78] We also disagree. The Dispute Settlement Understanding ("DSU"), the crown jewel of the WTO,[79] is a robust system and the appropriate venue where WTO Members shall solve their controversies about the trade effects of subsidies, which misaligned currencies are. Legal disputes are better alternatives than unilateral measures or currency wars.[80] Other difficult cases, such as *Japan — Measures Affecting Consumer Photographic Film and Paper*[81] and *European Communities — Measures Concerning Meat and Meat*

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[77] See Nathan Fudge, supra note 47, at 349.

[78] For instance, former Appellate Body chair James Bacchus , who said: "Whether the US or China prevailed, a WTO case would be self-defeating for both countries and disastrous for the global trading system." Bacchus, James (2010), "Don't Push the WTO Beyond Its Limits", The Wall Street Journal, 25 March.

[79] Deborah Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements, 96 American Journal of International Law (2002), at 595.

[80] See *supra* p. 2 n. 6.

[81] See Panel Report, Japan — Measures Affecting Consumer Photographic Film and Paper, WT/DS44/R/ (adopted 22 Apr. 1998).

Products (Hormones)[82] have strengthened rather than undermined the world trading system.[83] Furthermore, and although there is no *stare decisis* in the WTO; litigation, and the subsequent panels and Appellate Body's reports, will clarify and make more predictable the dormant legal texts about misaligned currencies.[84]

On the other hand, a dispute regarding countervailing measures imposed to offset the effects of misaligned currencies will raise questions related to both international trade and international finance. Then, a key issue is whether panels are obliged to consult the IMF and, if so, whether they shall accept any factual or legal determination from this international organization.[85] This paper argues that a panel is not obliged either to consult or follow any determination that the IMF makes regarding undervalued currencies.[86] This view is based on at least three arguments: the drafting of the WTO Rules (i.e., GATT Art. XV(2) and XV(9)(a), and the DSU); the nature of the WTO and the IMF as international institutions; and the jurisprudence of the WTO.[87]

GATT Art. XV(2) reads (emphasis added):

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[82] See Panel Report, European Communities — Measures Concerning Meat and Meat Products (Hormones), WT/DS26/R (adopted 13 Feb. 1998).

[83] See John Magnus & Timothy C. Brightbill, supra note 8, at 151.

[84] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 10 ("[T]he currency provisions in the WTO lie largely dormant in the text, in force on paper but never put on practice.").

[85] Deborah Siegel, supra note 74, at 561.

[86] But see Catharina E. Koops, supra note 34, at 9 and Deborah Siegel, supra note 74, at 590-97.

[87] A fourth reason to argue that a panel is not obligated to follow the IMF's factual or legal determinations is the fact that there are at least two countries that are WTO Members but not IMF Members: Cuba and Liechtenstein. If the IMF's opinion were dispositive in a case in which one of these countries is either the claimant, the respondent or a third party, the IMF will be applying its rules to a non-member country. Undeniable, it is unlikely that either Cuba or Liechtenstein will be a party in a dispute before the WTO concerning monetary reserves, balances of payments or foreign exchange arrangements. However, at least from a theoretical point of view, the possibility that a decision of the IMF may have effects over a country who is not a member of this organization seems absurd.

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

GATT Art. XV(2) refers to factual findings and legal determinations. In respect of factual findings, a plain meaning interpretation of the legal text indicates that the parties, not a panel, are the entities who shall consult the IMF in matters concerning monetary reserves, balances of payments or foreign exchange arrangements. This interpretation is in accordance with the old but relevant saying: *expressio unius est exclusion alterius*. Furthermore, the fact that the parties shall accept the factual findings of the IMF does not mean that such findings are irrefutable but just that they must be received as evidence and weighed against other documents, such as the reports from other experts.

Regarding legal matters, GATT Art. XV(2) provides that the parties shall accept the IMF's determination as to whether the country's measures that have kept an exchange rate at an artificial low level are in breach of the Articles of Agreement of this institution. Thus, the IMF is the competent authority to hold whether a country is in breach of its own rules. Yet, the IMF is not allowed to hold whether a currency misalignment violates the WTO rules or, more particularly, the ASCM. The IMF does not have the expertise to

know what a subsidy or a countervailing duty is. To hold otherwise would render illusory the delimitation of competences between the IMF and the WTO.

In turn, GATT Art. XV(9) provides (part b is omitted):

"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 . . . ."

An inattentive reading might lead to conclude that GATT Art. XV(9) allows WTO Members, even those not facing economic imbalances, to artificially undervalue their currencies. However, this conclusion is wrong for at least three reasons.

First, pursuant to GATT Art. XV(9), it is true that GATT 1947 cannot preclude the right that WTO Members have to impose exchange controls or exchange restrictions. However, there is no legal rule providing that anything in the ASCM shall preclude the use of exchange controls or exchange restrictions. In addition, the right to impose such controls or restrictions, as all rights, is not absolute. In the case of misaligned currencies, the limits are the legal rules of the ASCM, which is lex *specialis* and *posteriori* while GATT XV(9) is lex *generalis* and *priori*. Therefore, the ASCM prevails over the GATT 1947 in respect of misaligned currencies amounting to subsidies.[88] Art. 30.3 of the Vienna Convention on the Law of Treaties, providing that an early treaty (here GATT 1947)

[88] *See* the General interpretative note to Annex 1A, which reads: "In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 [which includes GATT 1947] and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization [e.g., the ASCM] . . . the provision of the other agreement shall prevail to the extent of the conflict.

applies only to the extent that its rules are compatible with those of a later treaty (here the ASCM), also supports this rationale. Second, legal rules should be construed in accordance with the time in which they are applied. In 1947, an interpretation by which world trading rules should not interfere with the exchange rates that countries have agreed to in accordance with IMF rules was reasonable. Thus, if the fixed exchange rates that were in legal force during the years following Bretton Woods would have been challengeable because of their trade effects; the international financial system, still in its infancy, might have collapsed. In contrast, nowadays, currencies fluctuate freely in the international markets and restrictions to artificial devaluations have more benefits than costs.

Third, and finally, the word "preclude" means "prevent from happening or make impossible."[89] According to this definition, neither GATT 1947 nor the ASCM make it impossible for WTO Members to devalue their currencies. Those multilateral agreements do not prevent or block any country from autonomously choosing its trade and foreign exchange policies. In practical terms, many countries continue subsidizing their domestic industries even though the subsidies might be in breach of the ASCM rules and that other countries, those suffering a harm, might impose countervailing duties. More particularly, some WTO Members might not be deterred from artificially undervaluing their currencies just because the measures taken to achieve this purpose might amount to a subsidy.

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[89] Oxford Dictionaries, *Available at:* http://oxforddictionaries.com/definition/preclude?region=us&q=preclude.

Besides GATT Art. XV(2), other WTO rules confirm that panels have the option, but not the duty, to consult the IMF as an expert in cases concerning the categorization of misaligned currencies as subsidies.[90] If the opinion of the IMF were dispositive, a panel would not be able to make an objective assessment of the matter in dispute, as DSU Art. 11 requires. Also, pursuant to DSU Art. 13, a panel has the right to seek information and technical advice from any individual or body which it deems appropriate (e.g., the IMF but also other institutions). DSU Art. 13 is *lex specialis* that prevails over GATT 1994, which is *lex generalis*.

A second argument to contend -- that a panel is not obligated to accept the IMF's findings hinges on the differences in the nature of this institution and the WTO. The IMF, which does not have a judicial body similar to the DSU, decides its disputes through a system in which their members vote in proportion to their financial contributions. Qualified majorities (between 70% and 85%) are needed to impose sanctions. Perhaps for this reason, and despite over 40,000 requests, the IMF has never found a country to be in breach of its rules on exchange rates.[91] The remedies also differ. The consequences of breaching the IMF's Articles of the Agreement are a curtailment of resources, a

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[90] The same is true for the IMF, which has the right, but not the legal duty, to consult the WTO in cases that, while decided in accordance with the Articles of Agreement, have trade effects. If one entity (e.g., the WTO) has the legal duty to consult the other entity (e.g., the IMF), and to follow its factual and legal findings, it will be against reciprocity that this second entity (the IMF) does not have the obligation to consult and follow the determinations from the first entity (the WTO). As no rule requiring the IMF to consult the WTO is in legal force, reciprocity suggests that there must not be any rule requiring the WTO to consult the IMF. See Deborah Siegel, supra note 74, at 572 (stating that GATT Art. XV is one-sided because no correspondence requirement is mandatory on the IMF).

[91] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 10 and Claus D. Zimmerman, supra note 6, at 426.

suspension of the voting rights or an expulsion.[92] In contrast, the remedies due to the breach of the ASCM are usually countervailing duties.

In light of the above, the discussion as to whether governmental measures that undervalue a currency are lawful may take place in two different and not exclusive arenas, each one with its own rules and proceedings: the IMF and the WTO.[93] They should not be mixed or confused. Thus, a country may be condemned before the WTO for undervaluing a currency but not before the IMF, or vice versa. This is not to say that the IMF and the WTO shall not seek cooperative solutions to the issues that misaligned currencies trigger. However, coordinated policies are neither identical decisions nor the equivalent to the IMF having the last say in international trade disputes.

The third reason to contend that a panel is not obligated to consult or follow the IMF's factual and legal determinations is the jurisprudence of the WTO. In practice, panels have not felt bound to consult the IMF. In *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, which concerned rules allowing a WTO Member to impose trade restrictions to safeguard its balance of payments, the panel sought the IMF opinion but not because of any rule requiring it to do so was in legal force but just under its authority to seek information from outside experts.[94] Once received, the IMF opinion was critically assessed and compared with information that

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[92] The IMF may also take other measures, such as curtailing technical assistance. See Claus D. Zimmerman, supra note 6, at 433.

[93] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at 10.

[94] Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, DS90/R (adopted Sept. 22 1999), paras. 5.11-13.

other entities, such as the Reserve Bank of India, provided.[95] Thus, the panel treated consultations and IMF's findings as they must be: discretionary and not dispositive. Furthermore, the panel in *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* gave the same weight to the part of the IMF's opinion concerning the matters that GATT Art. XV(2) addresses and to other parts of this opinion regarding financial matters that GATT Art. XV(2) does not mention.[96]

In another case, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, the panel considered that it needed to consult with the IMF whether a foreign exchange measure was an exchange restriction.[97] Since the panel did not acknowledged that it was obliged to either consult with the IMF or to accept its opinion, the word "needed" must have meant that the panel considered consultation as important or relevant, but not as mandatory.

In a third case, *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, Argentina unsuccessfully claimed that the Panel failed to make an objective assessment of the matter before it, as DSU Art. 11 requires, by not consulting with the IMF whether this organization had requested Argentina to levy a tax on imports in order to finance statistical services to importers, exporters and the general public.[98]

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[95] Deborah Siegel, supra note 74, at 594.

[96] See Deborah Siegel, supra note 74, at 592-93 note 96.

[97] Panel Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, DS302/R (adopted 19 May 2005) para. 7.139 ("The Panel considered during the proceedings that it needed to seek more information on the precise legal nature and status of the foreign exchange fee measure in the stand-by arrangement between the IMF and the Dominican Republic.").

[98] *See* Appellate Body Report, *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS/56/AB/R (adopted 22 Apr. 1998), paras. 75. 82-83.

The Appellate Body found that while consultation in this case might have been useful, the decision of not seeking advice from the IMF was within the Panel's discretion.[99] This discretion allows panels to decide not only whether to consult with an expert but also to choose the expert.[100] The Appellate Body also held that GATT Art. XV(2) is the only WTO rule "that requires consultations with the IMF."[101] This holding is in accordance with what this paper contends: GATT Art. XV(2) provides that parties (but not the Panel) shall consult fully with the IMF problems concerning monetary reserves, balances of payments or foreign exchange arrangements. What neither the Appellate Body held nor Art. XV(2) provides is that panels shall consult, or even worse, follow the IMF's opinions on monetary reserves, balances of payments, foreign exchange arrangements, or any other matter.

Lastly, the dispute *United States – Import Prohibition of Certain Shrimp and Shrimp Products* is also relevant even though it was not related to financial issues. In this case, the Appellate Body confirmed the right and discretion that panels have to seek and accept information.[102]

Section IV- Concluding Remarks

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[99] *See Id.* para. 86.

[100] *See Id.* para. 84 ("Pursuant to Article 13.2 of the DSU, a panel may seek information from any relevant source and may consult experts to obtain their opinions on certain aspects of the matter at issue. This is a grant of discretionary authority: a panel is not duty-bound to seek information in each and every case or to consult particular experts under this provision.").

[101] *See Id.* para. 84.

[102] Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/R (adopted 15 May 1998) para. 7.8 ("Pursuant to Article 13 of the DSU, the initiative to seek information and to select the source of information rests with the Panel.").

Not all undervalued currencies are a subsidy. However, a currency that is significantly deviated from its equilibrium value for more than the time needed to address economic imbalances is equivalent to a subsidy legally and economically speaking. In those cases, WTO Members suffering the trade consequences of misaligned currencies may impose countervailing duties following the guidelines of the ASCM. As always, if any affected WTO Member considers that its currency's undervaluation does not amount to a countervailable subsidy, it may challenge such duties before the WTO.

In a legal dispute before the WTO concerning misaligned currencies, a panel or the Appellate Body will be autonomous to reach a decision and any IMF factual or legal finding will amount to an authoritative but not dispositive expert opinion. The IMF does not have either the power or the expertise to decide issues such as whether a misaligned currency is a subsidy or whether a countervailing duty was imposed in accordance with the ASCM

This legal dispute before the WTO would address perhaps the most critical and far-reaching trade problem of this decade and, by doing so, be beneficial for the WTO and world trading system. In addition, it would be preferable to the unilateral measures or beggar-thy-neighbor policies that are undermining the credibility and predictability of WTO rules.[103] It is time for the debate to jump from the academic arena to the national

[103] See Gregory Hudson, Pedro Bento de Faria & Tobias Peyerl, supra note 20, at. 6. See also The Global Economy, How to Stop a Currency War, The Economist (Oct. 14, 2010). Available at: http://www.economist.com/node/17251850 (last visited Feb. 13, 2012).

governments and Geneva. Considering that the Doha Round is almost dead,[104] world trade cannot wait forever until either a political agreement is reached or new rules are approved. Therefore, neither the countries nor the WTO should remain dormant about misaligned currencies, unless they want to convert this institution in an entity that is powerless to deal with the crucial trade issues of the present time.[105]

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[104] Even if the Doha Round were revived, misaligned currencies would unlikely be part of the agenda. Indeed, WTO Members have missed several opportunities to explicitly address the issue of misaligned currencies in the past, such as the Tokyo and Uruguay Rounds. Incidentally, the fact that the issue of misaligned currencies has not been expressly addressed in such rounds does not mean that it cannot be dealt with on the basis of existing rules, such as the ASCM.

[105] See Vera Thorstensen, Emerson Marçal & Lucas Ferraz, supra note 5, at 18 ("The WTO cannot continue to ignore the effects that exchange rates have on the trade system and its rules, at risk of losing touch with reality and transforming the organization into just a sophisticated juridical fiction!").

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