

China's Currency Devaluation and WTO Issues

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- Is the WTO Competent to Deal With the RMB Devaluation Issue?

or

- Does the WTO Have Jurisdiction Over the RMB Devaluation Issue?

Picture of RMB Exchange Rate

- On one hand, China was blamed for intervention of RMB exchange rate;
- On the other it has appreciated RMB value by 26% since it introduced the reform on RMB exchange rate in 2006 .

- While pressurizing is often dubbed by some as a conspiracy in China (another Plaza Accord?), it is an issue that the reform falls short of the expectation in the eyes of its partners.

- Why? It boils down on the question whether China's exchange rate practice is lawful in international law?

- Where can the international law be found?

- IMF?

- WTO?

- Article IV, IMF Articles of Agreement:
exchange arrangement

- a code of conduct for members' exchange practice

or

- freedom of more choices in exchange arrangement?

- ***Background: The present version of Article IV was incorporated into the Articles by the Second Amendment of the Articles of Agreement in 1978.***

- Under the original par value system, a member's choice as to how it valued its currency against the currency of other members was very limited: the value had to be expressed in terms of gold, either directly or through the U.S. dollar.

As a complete departure from the par value system, Article IV legalizes a member's freedom to choose **whatever exchange arrangement it wished**—including floating and of course, fixed rate and pegged rate

- ***with respect to members' exchange rate policies, members should avoid pursuing policies that are designed ...to gain an unfair competitive advantage over other members.***

- The determination shall be based on the member's representation of its motives?
- or
- shall be made independently by the Fund?

- Has the IMF made such determination?

Not yet!

- China's exchange practice: a mix of pegged and floating system

- China is entitled to such a system
- The question is whether the arrangement is ***to gain an unfair competitive advantage over other members.***

- Is the IMF ready to determine?

- **the RMB rate issue can only become the subject matter of WTO dispute settlement proceedings where China's trade partner(s) lodge a complaint against China in the WTO dispute settlement body?**

- The issue now is whether **China's exchange practice has been translated into equivalent real trade measures** that could then be more readily evaluated under the rules of the WTO, e.g., under Article XV of GATT 1994, Article XXIII of GATT 1994 or Article 3 of SCM.

- A pre-conditional issue is whether the WTO has jurisdiction over such complaints?

**WTO's Jurisdiction over
Exchange Rate under GATT
Article XV, Para. 4**

- Distribution of labor resulting from an integrated grand design for the post-WWII global economic infrastructure-- The Bretton Woods Institutions.

- If WTO pronounced China's exchange rate frustrate the intent of the GATT before IMF clarifies China's exchange rate undermines the world trading system, it is fair to say that WTO would have been intruding the domains of IMF.

- unless IMF assesses the IMF-inconsistency of China's current managed floating exchange rate system, it is premature and hence inappropriate for WTO to assess the inconsistency of China's exchange rate system with Article XV, Para 4 of GATT.

- even if IMF outlaws China's exchange rate system, a finding that an exchange rate is "fundamentally misaligned" or "manipulated" under IMF Article IV:1(iii) does not automatically establish a violation of GATT Article XV(4)

- whether WTO has jurisdiction where China's partners lodge such a complaint depends on whether the exchange system has frustrated the intent of the GATT.

- The GATT history has indicated that keeping trade balance was ironically not in the mind of the framers of the world trading system.

WTO's Jurisdiction over RMB Rate under SCM

- **application of the provision prohibiting subsidies must be preconditioned on the premise that the definition of subsidies must be met.**

- **The definition in the SCM contains three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit.**

- **In the course of a protracted negotiation, some Members argued that there could be no subsidy unless there was a charge on the public account. Other Members considered that forms of government intervention that did not involve an expense to the government nevertheless distorted competition and should thus be considered to be subsidies.**

- **The SCM Agreement basically adopted the former approach, by requiring a financial contribution e.g., grants, loans, equity infusions, loan guarantees, fiscal incentives, provision of goods or services, purchase of goods.**

- **In the Chinese context of foreign exchange actions, it is difficult to say that a foreign exchange act bestows a financial contribution to exports because nearly 2 thirds of China's trade is processing trade, which involves imports of raw materials and export of final products.**

A Non-Violation Complaint over RMB Rate under GATT Article XXIII

- **Paragraph (1)(b) and (c) of GATT Article XXIII: “Nullification or Impairment”**

- **If any contracting party should consider that any benefit accruing to it directly or indirectly under GATT is being nullified or impaired or that the attainment of any objective of GATT ...**

- **...is being impeded as the result of the application by another contracting party of any measure, whether or not it conflicts with the provisions of GATT**

- Does the RMB rate suffice a “non-violation” complaint under GATT Article XXIII?

- Two conditions must be met
existence of **undervaluation** and **the magnitude of the undervaluation**

- Any undervaluation of the currency or an undervaluation of a particular magnitude?

- no WTO member can legitimately expect another member to maintain basically the same exchange rate policy that was in place when it joined the WTO

- Given that magnitude of undervaluation matters, the issue now is **AGAIN** whether the *WTO* is a right forum to make such a determination

Concluding remarks

For the WTO, it is also advisable to gauge whether to assess the WTO-consistency of the Chinese RMB issues before getting assured of the appropriateness of such complaints in the WTO forum.