Currency Undervaluation in International Law:
A Case for the WTO?

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In order to understand the issues behind this question, the first part of this thesis provides a short overview of the history of international regulation of currencies and the rise and fall of the Bretton Woods system. Parting from the principle of monetary sovereignty and its implications, the thesis provides a cursory glance at the development of international obligations regarding currencies and exchange rates.

The second part deals shortly with the relevant provisions of the IMF’s Articles of Agreement and the shortcomings related thereto. Article IV(1)(iii) of the IMF Articles of Agreement places an obligation on member states to avoid manipulating exchange rates in order to gain an unfair competitive advantage over other members. Despite in theory providing an answer to the problem of currency undervaluation, this provision is in practice essentially inoperative, due to the subjective element included in it. Even in the unlikely case that the IMF were to reach the decision that one of its members was in breach of this Article, it has no effective dispute settlement system it could avail itself of if the said member state did not comply with the IMF’s recommendations to remove the breach.

With the IMF being unable to effectively deal with the issue, the attention of politicians and academics alike has turned to the WTO, which provides an extremely effective dispute settlement mechanism. Due to its tariff-cum-subsidy effects, currency undervaluation makes it possible for WTO members to circumvent their obligations under the WTO agreements by nullifying, or at least diminishing, the effects of tariff concessions and eluding the prohibition on granting export subsidies. This thesis aims to provide an in-depth analysis of the WTO provisions that are most probable to be invoked with the aim of curbing currency undervaluation: Article XV of the General Agreement on Tariffs and Trade and the WTO provisions on subsidies. As an integral part of this examination, the thesis first discusses the relationship between the International Monetary Fund and the World Trade Organization in currency-related matters and the division of jurisdiction between the two institutions. The main finding in this regard is that although the interpretation of these provisions could in theory be stretched in order to cover currency undervaluation, the WTO cannot at present provide a sustainable answer to the issue of currency undervaluation.

This thesis argues that the problems in adjudicating currency manipulation essentially arise from historical developments and the failure to adapt the instruments of international law to a new economic reality. This, together with the fear of overlapping jurisdictions between international institutions, has led to a loophole in international economic law. Initially the division of authority between the WTO and the IMF was clear: exchange rate issues under the par value system were a matter to be dealt with exclusively within the IMF. After the breakdown of the par value system, misuse of monetary policies became easier and more frequent, but nothing was done to reinforce the authority of the IMF. This has led to a situation where the IMF has the jurisdiction to deal with exchange rate issues, but lacks an effective enforcement mechanism to ensure that its rulings are followed. The WTO on the other hand has at its disposal an extremely effective dispute resolution mechanism but lacks jurisdiction regarding currency issues.

This thesis departs from the generally accepted truth that an undervalued currency functions in practice as a subsidy to exports and tariff on imports. By using the method of legal dogmatics, the thesis analyzes how currency undervaluation can be assessed under international law, focusing on the examination of whether invoking the provisions of the IMF Articles of Agreement or WTO agreements to challenge currency undervaluation could be successful.
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<td>AB</td>
<td>Appellate Body</td>
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<td>DSU</td>
<td>Understanding on Rules and Procedures Governing the Settlement of Disputes</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>International Monetary Fund</td>
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1 Introduction

Currency undervaluation is a well-known and commonly used method for stimulating economic growth. Such a currency policy functions in practice as a subsidy to exports and tariff on imports. As far back as the 1930’s, currency devaluation was used by states in order to promote exports that would stimulate growth and help them out of recession. At the time, devaluations developed into a beggar-thy-neighbour -policy, leading to a spiral of competitive devaluations that did little to help states recover from the Great Depression.¹

The lessons learned during the Great Depression and its aftermath led to the establishment of the Bretton Woods system, including the International Monetary Fund (IMF) and what went on to become the World Bank. A failed attempt at establishing the International Trade Organization resulted in the General Agreement on Tariffs and Trade (GATT), which became the foundation of the World Trade Organization (WTO) when it came into existence in 1995. In joining these institutions, states agreed to limit their sovereignty over trade-related and monetary affairs in order to prevent the likes of the Great Depression from happening again. Ironically, as will be examined in this paper, the IMF and WTO essentially lack the ability to effectively prevent currency manipulation, despite the original rationale lying behind their establishment.

The situation in the first decades of the 21st century is quite different from that of the 1930’s, and countries are unlikely to use competitive devaluation as a tool even during global economic crises, foremost because they now have a much wider set of tools available to promote economic recovery.² However, what could be considered the contemporary equivalent of competitive devaluations is the act of intervening heavily on the currency market with the aim of preventing a currency from appreciating. This method is used by a number of countries to this day. Although various countries (e.g. India, Brazil, Indonesia, and Japan) have intervened in the exchange market or applied capital controls in order to prevent the appreciation of their currencies,³ the case of the Chinese yuan is by far the most famous, and will for this reason be used as an example throughout this paper.

The People’s Democratic Republic of China (“China”) applied a dual exchange rate regime until 1994, when it unified its exchange rates into one, which was pegged to the dollar at the value of 8.28 RMB per USD. In 2005, China announced it would end the peg, appreciate the yuan by 2 per cent and switch to a managed float in which the value of the renminbi was tied to a basket of currencies, not the dollar alone. Although this reform allowed for the renminbi to appreciate by 20 per cent by the year 2008, numerous economists and politicians argue that the exchange rate is still significantly undervalued due to the heavy interventions of the People’s Bank of China on the market.

The undervalued yuan functions as a catalyst for China’s export-driven economic growth, simultaneously discouraging imports by making them expensive. Thanks to its currency policy, by the end of the year 2013, China had accumulated foreign currency reserves worth 3.66 trillion USD. The huge economic imbalances caused by this surplus have caused concern in the international community and during the last ten years, academics, economists and politicians in the United States and all over the world have debated on what could, and what should, be done about the situation. Suggestions have varied from diplomatic consultations and unilaterally imposed countervailing duties to a full-blown dispute settlement procedure under the WTO. Despite the vigorous debate and even a number of legislative and administrative initiatives in the United States, so far no real action has been taken.

This paper uses the method of legal dogmatics to analyze how currency undervaluation can be assessed under international law, focusing on the examination of whether invoking the provisions of the IMF Articles of Agreement or WTO agreements to challenge currency undervaluation could be successful. In order to understand the issues behind this question,

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the first part of the paper provides a short overview of the history of international regulation of currencies and the rise and fall of the Bretton Woods system. The second part deals shortly with the relevant IMF provisions and the shortcomings related thereto, after which the relationship between the International Monetary Fund and the World Trade Organization is examined. The third part of the paper aims to provide an in-depth analysis of the WTO provisions that are most probably to be invoked with the aim of curbing currency undervaluation: Article XV of the General Agreement on Tariffs and Trade (GATT) and the provisions on subsidies. Before presenting its conclusions, the last part of the paper provides a cursory review of the solutions that have been proposed in order to address problem of currency undervaluation and the trade distortions caused by it.
2 Monetary Sovereignty

2.1 The Principle of Monetary Sovereignty

One of the main reasons why USA has been reluctant to directly challenge China’s currency policy is that currency arrangements are a delicate political subject, due to the long-established principle of monetary sovereignty. Strangely enough, this principle has not been expressly recognized in any instrument of international law, not even in the Articles of Agreement of the International Monetary Fund.\(^9\) However, it has been affirmed as a general principle of international law by the Permanent International Court of Justice in the *Serbian Loans* case, in which it was stated that it is a “generally accepted principle that a State is entitled to regulate its own currency”.\(^10\) According to the principle of monetary sovereignty, each state has the exclusive right to issue currency, determine and change the value of that currency and regulate the use of that currency and any other currency within the limits of its territory.\(^11\) For this reason, a state can freely depreciate its currency without committing an “international wrong” under customary international law.\(^12\)

This right to exert exclusive legal control over its currency can be limited by the state itself only by entering into international agreements in which it agrees to surrender parts of this right.\(^13\) An international legal monetary framework was first developed during the years between the two World Wars,\(^14\) and the first attempts to regulate monetary affairs on an

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\(^10\) *Case Concerning the Payment of Various Serbian Loans Issued in France*, Permanent Court of International Justice, Judgment No.14, 12 July 1929, at ¶ 96.


\(^12\) Mann, F. A.: *The Legal Aspect of Money*, Second Edition, Oxford (1953) at 419. Mann proposes that there is an exception to this general rule, one that results from the doctrine of abuse of rights: “If the monetary legislation or practice of a country pursues the deliberate purpose of injuring foreigners, this amounts to an international delinquency” (p.423). According to Mann, it is generally too difficult to prove any “impropriety” in the application of monetary rules, which is one of the reasons why states have used treaties to define the duty of non-discrimination (p.425).

\(^13\) The evolution of the concept of monetary sovereignty has been the subject of many articles in recent years, many having argued that, with globalization and financial integration, monetary sovereignty has been eroded. For an analysis of the evolution of the concept of monetary sovereignty, see Zimmermann, Claus D. ‘The Concept of Monetary Sovereignty Revisited’, *The European Journal of International Law*, Vol. 24 no. 3 (2013) at 797-818.

\(^14\) It must be noted that even before this period, indeed even as far back as the Middle Ages, agreements regarding exchange rates of currencies have been used between states or the like. However, these agreements were uncommon, bilateral, did not include international cooperation and moreover their obligations were
international level were limited to declarations and loose agreements of a soft nature.\footnote{15} When these instruments failed to bring about the desired effect of stabilizing the international economy, states took further steps in limiting their monetary sovereignty and as a consequence the IMF was created in 1944.\footnote{16}

\subsection*{2.2 The Bretton Woods System}

With the introduction of the Bretton Woods system, states were imposed with three hard obligations concerning monetary policy: the obligation to maintain par values and a unified exchange rate regime as well as the prohibition to introduce restrictions on current accounts. The obligation to maintain a unified exchange rate regime is still in force (Article VIII Section 3), as is the obligation to avoid restrictions on current payments (Article VIII Section 2). Ironically, the most well-known of these obligations, the par value system, turned out to be the biggest failure and was officially ended in 1977 when the Second Amendment to the International Monetary Fund’s Articles of Agreement entered into force.

Under the par value system, states were obliged to set a pegged rate, or “par value”, for their national currency (in relation to the US dollar), and intervene in the currency markets in order to keep exchange rate fluctuations within a limited ‘band’. The value of the US dollar in turn was tied to gold. States were allowed to adjust the par value of their currency hardly followed. The year 1865 saw the creation of the Latin Monetary Union between Italy, France, Belgium, Greece and Switzerland. This was perhaps the first attempt at a multilateral monetary system, however it was short-lived and generally considered a failure. The most important difference between these agreements and those of the Bretton Woods is that the preceding agreements never challenged the generally accepted truth that currency matters were not an issue to be regulated by the international community, but rather a matter that was to be left purely to domestic regulation. It was only with the Bretton Woods system that this belief was questioned. (See Zamora, Stephen: ‘Sir Joseph Gold and the Development of International Monetary Law’, \textit{International Lawyer} (ABA) Vol. 23, Issue 4 (Winter 1989) at 1011-1013 and Mann, F. A.: \textit{The Legal Aspect of Money}, Second Edition, Oxford (1953) at 425).

\footnote{15} For example in the 1920’s, governments of major European states agreed on “the principles of a gold exchange standard”. Although these principles are often called the “norms of the gold standard”, they were of a soft nature and did not form legally binding obligations for the signatory states. (See Simmons, Beth: ‘The Legalization of International Monetary Affairs’, \textit{International Organization} 54, 3 (2000) at 576).

This is not to say, however, that these declarations and agreements were of no significance in the development of an international monetary system. On the contrary, these soft law instruments functioned as the first step in the process that led to the creation of the international monetary system. To quote Adam Boyle, “soft law instruments can be vehicles for focusing consensus on rules and principles, and for mobilizing a consistent general response on the part of States”. (See Boyle, Alan: Soft Law in International Law-Making, in Evans, Malcolm D. (ed.) \textit{International Law} (Second Edition, 2006), at 141-149.

by following certain established procedures when this was necessary for the correction of a ‘fundamental disequilibrium’ in their balance of payments, but only with the permission of the IMF. Seasonal, cyclical temporary changes in the equilibrium of a currency were not considered justification for a change in the par value of a state’s currency. The provisions of the original IMF Articles of Agreement therefore functioned in such a manner that the relationships between currencies of different states remained fixed, with gold as the common denominator.

The Articles of Agreement of the IMF constituted a turning point in the history of international monetary affairs because, as Simmons puts it, it was the first time that the international community explicitly recognized that exchange rates were a matter of international concern. From an issue left completely to each state’s own discretion, exchange arrangements thus became a matter closely regulated by the international community.

20 This is not to say, however, that because of the power granted to the IMF, member states no longer had control over their currencies. Gold points out that a “primary purpose of the code was to divide authority over exchange rates between the Fund and its members”. The original Articles of Agreement contained numerous compromises, for example the fact that only a member state itself was allowed to propose a change in the par value of its own currency. Moreover, the Agreement contained a “safety valve” provision, under which a member could oppose the Fund’s objection regarding the determination of the value of its currency, without being found to be in violation of its obligations under the IMF. In practice, however, this “safety valve” had very little significance, and was in fact only used once. (See Gold, Joseph: ‘International Monetary Law in an Age of Floating Currencies’, Vol.73 American Society of International Proceedings 1 (1979) at 3).
3 Limitations on Exchange Arrangements Set in the IMF Articles of Agreement

3.1 The End of the Bretton Woods System

By the end of the sixties, the exchange rate of the US dollar was grossly overvalued, and in 1971 the dollar’s convertibility to gold was ended. This marked the end to the par value system and by 1973 most major currencies were allowed to float freely against each other. This led to the amendment of the IMF Articles of Agreement in 1977 and the establishment of the current obligations of IMF members with regards to their currency policy. According to Article IV Section 2(b) of the IMF Articles of Agreement, states are allowed to freely choose the currency arrangement they want to implement. In practice, states can choose from a wide range of exchange rate regimes: a currency can be allowed to float freely or it can be tied (‘pegged’) to another currency or basket of currencies, or the state can even choose to use the currency of another state. The only absolute limitation is that the state may not determine the value of its currency in terms of gold.

In addition to the limitation regarding gold, the IMF Articles of Agreement include only two restrictions on the states’ right to determine the value of their currency. Firstly, IMF members shall not introduce or maintain multiple currency practices.21 Secondly, members shall not manipulate exchange rates in order to prevent effective adjustment of balance of payments or to gain an unfair competitive advantage over other members.22

These amendments arose from the recognition that the stability of the international monetary system cannot be achieved by stabilizing exchange rates themselves, but rather requires that exchange rates adjust in response to underlying conditions in the economy. The rigidity of the par value system had led to disequilibrium in the international economy, because states no longer adjusted their currencies in response to changes in the economy, therefore either delaying or completely preventing balance of payments adjustments between states.23

21 IMF Articles of Agreement, Article VIII Section 3.
22 IMF Articles of Agreement, Article IV Section 1(iii).
3.2 IMF Article IV(1)(iii): Exchange Rate Manipulation

According to Article IV(1)(iii) of the Articles of Agreement of the International Monetary Fund, each member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. This obligation comprehends the maintaining of both an undervalued and an overvalued exchange rate. Unlike the other obligations set in Article IV(1), which deal with domestic policies, this is one of a ‘hard’ nature, setting a clear prohibition, which reflects the fact that exchange rate regimes are of concern to the international community.24

The phrase “manipulation of exchange rates” is not defined in the article or elsewhere in the Articles of Agreement.25 The IMF’s 2007 Decision on Bilateral Surveillance over Members, however, provides further guidance on the meaning of this phrase.26 Section 15 of the Decision provides that the following developments could be indications that a member state is manipulating its exchange rate in the sense of Article IV(1)(iii):

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or

(b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

26 Bilateral Surveillance over Members’ Policies, Executive Board Decision, June 15, 2007, Annex Section 1 in fine.
(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) fundamental exchange rate misalignment;

(vi) large and prolonged current account deficits or surpluses; and

(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows.27

The Annex of the Decision also deals with currency manipulation and Article IV(1)(iii). Section 2 of the Annex states that “[A] member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund determined both that: (a) the member was manipulating its exchange rate or the international monetary system and (b) such manipulation was being carried out for one of the two purposes specifically identified in Article IV, Section 1(iii)”, i.e. prevention of the effective adjustment of balance of payments or the gaining of an unfair competitive advantage over other members. Article IV(1)(iii) is therefore composed of two elements, an objective and a subjective element, both of which must be fulfilled in order for a breach of the article to be established.

The objective element is fulfilled by the existence of official interventions which affect the exchange rate. According to the interpretation of Article IV(1)(iii), manipulation of the exchange rate can happen through interventions in exchange markets and/or by imposing capital controls. Currency manipulation covers not only scenarios in which interventions are aimed at moving the exchange rate in either direction, but also those in which the intent of the government is to prevent such movement.28

The fulfillment of the objective element alone gives little indication of whether a currency is being manipulated in the sense of Art. IV(1)(iii). Indeed, the maintaining of a pegged exchange rate requires constant and possibly even heavy intervention in the currency market, and yet it is completely legitimate under the IMF Articles of Agreement. Moreover the obligation to “promote stability by fostering … a monetary system that does not produce erratic disruptions” as laid out in Art. IV(1)(ii) would seem to require interventions in certain situations regardless of the exchange rate regime chosen by the

27 Bilateral Surveillance over Members’ Policies, Executive Board Decision, June 15, 2007, Section 15.

Exchange rate misalignment can also be “the unintended side effect of macroeconomic policies aimed at achieving domestic objectives or the result of distortions in the international financial architecture or in domestic structural conditions”. The concept of currency manipulation has been worded in such a broad manner that practically all countries could be said to be constantly manipulating their currencies. For this reason great weight is put on the phrase “in order to” and the subjective element it introduces into the provision.

In order to fulfill the subjective element of Article IV(1)(iii), it must be established that the state in question has manipulated its currency for the purpose of preventing effective balance of payments or gaining an unfair competitive advantage over other member states. This requires a determination of the intent of the state. The state is required to give its explanation for the interventions and it is given the benefit of any reasonable doubt. However, it is ultimately up to the Fund to make an independent assessment of the state’s intent, taking into account “all available and relevant information regarding the member’s exchange rate policy”.

It is the establishment of this subjective element that makes the application of Article IV(1)(iii) problematic. The macroeconomic effects of exchange rate policies are equivocal and complicated, and accordingly the reasons for maintaining a certain exchange rate policy can vary greatly from state to state. In its over 30-year history of bilateral surveillance regarding Article IV (consisting of over 40,000 consultations), the IMF has never found a single state to manipulate its currency in the sense of Article IV(1)(iii), and it is highly unlikely to do so in the near future. The issue of currency manipulation, in particular the establishment of a state’s intent, is a matter of such political delicacy that it renders the application of Article IV(1)(iii) extremely difficult (if not impossible) in

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practice. As stated by Zimmermann, “the requirement of intent renders the key provision of the IMF’s code of conduct essentially inoperative”.\textsuperscript{33}

Moreover, even if the IMF was to reach the decision that one of its members was in breach of Article IV(1)(iii), it has no effective dispute settlement system it could avail itself of if the said member state did not comply with the IMF’s recommendations to remove the breach. The Fund’s options are limited to the declaration of ineligibility to use the Funds’ resources, suspension of voting rights or expulsion from the IMF. In the case of important economic and political powers such as China, Japan and the United States, such threats are as good as empty.\textsuperscript{34}

It is for these reasons that academics, economists and politicians have turned to the WTO in the hope that its agreements, along with its effective dispute settlement mechanism, might provide a solution to this apparent loophole in international economic law.


\textsuperscript{34} Zimmermann, Claus D.: ‘Exchange Rate Misalignment and International Law’, 105 American Journal of International Law (2011) at 433.
4 The IMF-WTO Relationship

4.1 The Effects of Exchange Rate Arrangements on International Trade

Although the exact effects of exchange rate arrangements on international trade are highly debated, the fact that strong interlinkages between the two exist is unquestionable. During the last couple of decades, the debate has shifted from the impact of exchange rate volatility on trade to the trade effects of exchange rate misalignment, i.e. exchange rate undervaluation or overvaluation. The economics behind the effects of exchange rate misalignment have been the subject of many studies in the last couple of decades.

For the purpose of this study it is not necessary to go into the macroeconomic theories behind exchange rate misalignment. It is sufficient to state that a generally accepted truth is that an undervalued currency functions as a de facto tariff-cum-subsidy. A weak currency makes exports cheap and thereby incentivizes companies to export their products instead of selling them on the domestic market. Simultaneously, it makes imports relatively expensive, since more units of the domestic currency are needed for each unit of foreign currency. This functions as a de facto tariff on imports, which raises the prices of imported products on the country’s domestic market, causing demand to fall and ultimately limiting the quantity of imports.

In short, currency manipulation makes it possible for WTO members to circumvent their obligations under the WTO agreements by nullifying, or at least diminishing, the effects of tariff concessions and eluding the prohibition on granting export subsidies.

4.2 Cooperation Prior to the WTO

These interconnections were recognized already when the Bretton Woods System was born decades before the establishment of the WTO, and consequently cooperation between

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organizations or regimes governing issues related to international trade and finance was seen as an inevitable condition for a balanced global economy. Article I(ii) of the IMF Articles of Agreement states as one of the purposes of the Fund the facilitation of the “expansion and balanced growth of international trade”. An agreement on “Relations between ITO and IMF” was drafted by the Interim Commission for the ITO in 1948. This agreement set the obligation to consult between the two organizations, defined a coordinated policy and provided the institutional framework to enable this. However, since the ITO never came into existence, no formal agreement between trade and monetary organizations was needed and the agreement was never entered into. Since the GATT was only a multilateral treaty and established no international organization, it was deemed sufficient that a statutory link with the IMF was incorporated into the agreement.  

This link between the two systems was provided in the GATT in order to “neutralize” the problem of overlapping and possibly contradictory regulation. Article XV(1) of the GATT provides that “the contracting parties shall seek co-operation with the International Monetary Fund to the end that the contracting parties and the Fund may pursue a coordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the contracting parties.” The article parts from the presupposition that exchange measures are within the jurisdiction of the IMF whereas trade measures are within the jurisdiction of the GATT. Article XV(4) goes on to state that “Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.”

The question of jurisdiction between the two systems therefore boils down to the interpretation of the terms “exchange action” and “trade action”, which, essentially, are two sides of the same coin. The 1981 case regarding Italian deposit schemes is a perfect example of this.

The issue raised in this case was whether the Italian import deposit scheme constituted a charge on importation or a charge on the transfer of payments and consequently, did it fall under the jurisdiction of the GATT (and therefore constitute a violation of Article II) or under the jurisdiction of the IMF (in which case there could be no violation of the GATT).

The Committee on Balance-of-Payments Restrictions made the following analysis:

“If the distinction between import and payments measures were made by taking into account the purpose or the effect of the action, the Italian scheme would probably be both a trade and an exchange measure: it is intended to improve Italy's payments position as well as to restrain imports, and it has had an impact both on payments for imports and the imports themselves. If however the distinction were made by looking at the restrictive technique used, the Italian deposit scheme would probably have to be regarded as an exchange measure since it is formulated and operated as a requirement to be fulfilled for the purchase of foreign exchange rather than for importation.”

The difficulty of this distinction is illustrated well by the following statement of a special sub-group set in 1954 during the Review Session, to which the Balance-of-Payments Committee also refers to in the Italian case: “in many instances it was difficult or impossible to define clearly whether a government measure is financial or trade in character and frequently it is both”. The sub-group however went on to note that the division of work between the contracting parties and the Fund was in practice “based on the technical nature of government measures rather than on the effect of these measures on international trade and finance”. Despite this finding, the conclusion of the Committee in the 1981 case of Italy is that the contracting parties to the GATT have never decided whether distinguishing between trade and financial measures should be based on the effects and purpose of the measure or the actual technique by which it is implemented. The approach under the GATT has been “to examine particular restrictive measures affecting trade independent of the form that the measures took”.

The same sub-group’s report the Committee on Balance-of-Payments Restrictions also states that “the more important problem was not that of defining the respective jurisdictions of the contracting parties and the Fund but that of establishing more effective machinery for consultation in accordance with Article XV.”

39 Committee on Balance-of-Payments Restrictions, Consultation with Italy (Deposit Requirement for Purchase of Foreign Currency), Background note by the Secretariat, 25 September 1981, BOP/W/51 at ¶9.
40 Committee on Balance-of-Payments Restrictions, Consultation with Italy (Deposit Requirement for Purchase of Foreign Currency), Background note by the Secretariat, 25 September 1981, BOP/W/51 at ¶11.
41 GATT Analytical Index on Article XV at 435 (italics added).
42 Committee on Balance-of-Payments Restrictions, Consultation with Italy (Deposit Requirement for Purchase of Foreign Currency), Background note by the Secretariat, 25 September 1981, BOP/W/51 at ¶14.
43 GATT Analytical Index on Article XV at 429.
It must be kept in mind, however, that all these statements were made at a time when exchange rates were based on par values and therefore to a large extent “under the control”, so to speak, of the IMF. As long as exchange rates were kept stable, they did not easily cause disturbances in trade flows and were therefore of limited concern to GATT contracting parties. It was only once the par value system was abolished in 1977 and exchange rates were allowed to float freely that the problem became significant under the GATT, for no changes were made to the agreement in order to adjust to the new system of continuously fluctuating exchange rates.\(^{44}\)

In 1975 the GATT Council established the Consultative Group of Eighteen in order to “facilitate the carrying out, by the Contracting Parties, of their responsibilities, particularly with respect to … the co-ordination … between the GATT and the IMF”.\(^{45}\) In its final report, the Consultative Group announced that the “most effective contribution the GATT could make to the resolution of trade and financial problems would be the energetic pursuit of its normal activities – the identification of trade problems, efforts to define solutions and help in implementing them”.\(^{46}\)

In 1984 the contracting parties GATT addressed the problem in a statement in which they acknowledged that “in certain circumstances exchange market instability contributes to market uncertainty… and may lead to pressures for increased protection”.\(^{47}\) The contracting parties urged the IMF to take into account their concern and “review the operation of the international monetary system with a view to possible improvements”.\(^{48}\)

Despite the recognized need, no formal action was ever taken in order to clarify the relationship and division of jurisdiction between the GATT system and the IMF.

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\(^{44}\) Muller, Carolina, Ramos, Daniel and Thorstensen, Vera: ‘The “Missing Link” between the WTO and the IMF’, *Journal of International Economic Law* 16(2) at 371-372.

\(^{45}\) History of the Consultative Group of Eighteen, Note by the Secretariat MTN.GNG/NG14/W/5, (available at http://www.wto.org/gatt Docs/English/SULPDF/92020138.pdf) at 1.


\(^{47}\) *Exchange Rate Fluctuations and Their Effect on Trade*, Fortieth Session of the Contracting Parties, Action taken on 30 November 1984, L/5761 at ¶1.

\(^{48}\) *Exchange Rate Fluctuations and Their Effect on Trade*, Fortieth Session of the Contracting Parties, Action taken on 30 November 1984, L/5761 at ¶3.
4.3 WTO and IMF Cooperation

The question regarding cooperation between trade and monetary issues was addressed again in 1987 during the Uruguay Round, which led to the establishment of the World Trade Organization. The Ministerial Declaration determined as one of the aims of negotiations the development of understandings and arrangements inter alia “to increase the contribution of the GATT to achieving greater coherence in global economic policy-making through strengthening its relationship with other international organizations for monetary and financial matters”.\(^49\) The Functioning of the GATT System (FOGS) negotiating group was established in order to implement this specific part of the mandate.\(^50\) The result of these negotiations was no formal agreement on the linkages and cooperation between these institutions, but a rather vague resolution included in the Marrakesh Declaration.\(^51\) Article III of the Declaration on the functions of the WTO states “with a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies”.\(^52\)

The Marrakesh Declaration was followed by the so-called Coherence Declaration (The Declaration on the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking), in which it was stated that the WTO should “pursue and develop cooperation with the international organizations responsible for monetary and financial matters”. This is to be done while respecting the mandate and the necessary autonomy in decision-making procedures of each institution, and more importantly, while avoiding the imposition of cross-conditionality or additional conditions on member states. The declaration also mandated the Director-General of the WTO “to review with the Managing Director of the International Monetary Fund and the President

\(^{49}\) Ministerial Declaration on the Uruguay Round, 20 September 1986, MIN(86)/W/19.


\(^{52}\) Final Act of the Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (Marrakesh Declaration), 15 April 1994, Article III.5.
of the World Bank, the implications of the WTO's responsibilities for its cooperation with the Bretton Woods institutions, as well as the forms such cooperation might take”.

In November 1996 the General Council of the WTO adopted a decision which provided for the mutual granting of observer status, consultation between the secretariats and the staff of the institutions, exchange of information and access to databases as well as administrative cooperation.

All in all, however, the relationship between the WTO and IMF remains based on the articles of the GATT and the Articles of Agreement of the IMF, just as it was during the GATT era. This is reaffirmed by the Declaration on the Relationship of the World Trade Organization with the International Monetary Fund, which is included in the final act of the Uruguay Round. In this short, one-page document, contracting parties “reaffirm that, unless otherwise provided for in the Final Act, the relationship of the WTO with the International Monetary Fund, with regard to the areas covered by the Multilateral Trade Agreements in Annex 1A of the WTO Agreement, will be based on the provisions that have governed the relationship of the contracting to the GATT 1947 with the International Monetary Fund.”

Although the GATT includes numerous other references to the IMF, for the purpose of this study, the paper will concentrate on single most important provision, GATT Article XV, which governs exchange arrangements.

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54 Agreements between the WTO and the IMF and the World Bank, 18 November, 1996, WT/L/1996.

55 Final Act of the Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (Marrakesh Declaration), 15 April 1994, Declaration on the Relationship of the World Trade Organization with the International Monetary Fund, at 393.

56 E.g. Article II(6), Article VII(4) and Article XIV.
5 Challenging Currency Undervaluation under the WTO

5.1 General

Before addressing the substantive provisions of the WTO agreements, it is first necessary to establish what kind of action from the state is required in order for currency undervaluation to be even addressable under the WTO dispute settlement system. Article 3.3 of the Dispute Settlement Understanding provides that only “measures taken by another member” can be resolved in dispute settlement.\(^{57}\) Naturally this excludes from the jurisdiction of the WTO any fluctuations in exchange rates that are caused by purely economic reasons, without any intervention from the state or any other entity.\(^{58}\) However, even in cases where undervaluation is caused or maintained by interventions by the central bank, it cannot be automatically inferred that these interventions constitute “measures taken by another member”.

Article 3.3 of the DSU was interpreted in *US – Corrosion-Resistant Steel Sunset Review*, in which the Appellate Body found that the phrasing “measures taken by another member” must be interpreted broadly. The Appellate Body stated that “in principle, any act or omission attributable to a WTO member can be a measure of that member for purposes of dispute settlement proceedings”, and such acts are usually “the acts or omissions of the organs of the state, including the executive branch”.\(^{59}\) Although in this case the Appellate Body did not find it necessary to consider to the extent which acts of private entities could be attributed to members,\(^{60}\) the issue had been discussed at length by the panel previously in the case *Japan – Film*. The panel recalled that although the term “measure” in the WTO agreements refers to policies and actions of governments, and not those of private parties, GATT panels have been faced with making difficult judgments in cases where actions that appear to be private actions “may nonetheless be attributable to a government because of

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\(^{57}\) Article 3.3 reads: “The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.”


\(^{59}\) Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review* at ¶81.

\(^{60}\) Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review* at ¶81, also footnote 78.
some governmental connection to or endorsement of those actions”. The panel drew the conclusion that “the fact that an action is taken by private parties does not rule out the possibility that it may be deemed to be governmental if there is sufficient government involvement with it” and that whether private actions can be attributable to the government must be established on a case-by-case basis. In case Japan - Film, the panel reached the conclusion that the measures in question were in fact attributable to the government, basing its decision partly on the argument that a “finding to the contrary would create a risk that WTO obligations could be evaded through a Member's delegation of quasi-governmental authority to private bodies”.

In many countries central banks are formally independent from organs of the state, and are not under the direct control or even influence of the state’s executive branch. However, taking into consideration the rulings of the panel and the Appellate Body in the cases cited above, it is probable that in most cases action taken by the state’s central bank would be deemed a “measure taken by another member” in the sense of DSU Article 3.3 and could thus possibly constitute a violation of a WTO provision. As Zimmermann also points out, in the absence of an explicit WTO ruling on this precise question, it appears safe to say that formal central bank independence is insufficient for considering measures taken by central banks as something other than as "measures taken by another Member".

Nevertheless, the wide array of specific actions states (or their central banks) can take in order to achieve and maintain an undervalued currency, as well as the equivocality of the actual effects of these actions on the exchange rate, can make proving a breach of a WTO provision a rather burdensome ordeal for the complaining party. In order to even have currency undervaluation analyzed in the light of substantive WTO provisions, the complainant would first have to successfully prove that the undervalued exchange rate is in fact maintained by actions taken by the member state. This would mean proving first that there is an appreciable undervaluation of the state’s currency, and second, that this undervaluation is the cause of specific, identifiable measures that are attributable to the

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61 Panel Report, Japan – Film at ¶10.52.
62 Panel Report, Japan – Film at ¶10.56.
63 Panel Report, Japan – Film at ¶10.328.
state in question. Only once these two elements have been established can the adjudicating body move on to assessing whether these measures are consistent with WTO obligations.

Although an undervalued currency’s effects on trade are complex, and therefore the extent of WTO obligations possibly breached by maintaining one wide-ranging, the most obvious one, and therefore the first one to consider, is GATT Article XV, titled Exchange Arrangements. Article XV of the GATT governs exchange arrangements and functions therefore as a link between the WTO and the IMF. As such it has also been proposed as providing an answer to the issue of trade distortions caused by undervalued currencies. Article XV provides both a substantial and procedural link between the WTO and the IMF. The substantial link is established by paragraphs 4 and 9, which are both examined in detail below. The procedural link is determined in paragraph 2, 3, and 5, of which paragraph 2 is the most relevant to this study.

5.2 GATT Article XV(4)

5.2.1 Interpreting GATT Article XV(4)

Paragraph 1 of Article XV states that the contracting parties shall seek cooperation with the IMF so as to pursue a coordinated policy with regard to exchange questions within the jurisdiction of the IMF and trade questions within the jurisdiction of contracting parties to the WTO. Paragraph 4 of the article goes on to give concrete meaning to this division of jurisdiction by stating that contracting parties “shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund”. It is this provision that has been invoked by academics and state representatives alike as the solution to the evaluation of currency undervaluation under WTO law. In practice, the paragraph prohibits


68 The remaining paragraphs 6-8 are not relevant for this study. Paragraph 6 states that contracting parties not yet members of the IMF shall either become members or enter into special arrangements with the contracting parties. Paragraph 7 determines the details of such an arrangement and paragraph 8 establishes the obligation of a contracting party not a member of the IMF to provide information to other contracting parties.
contracting parties from circumventing their obligations under the WTO by adopting exchange actions that distort or restrict trade.

At first thought it seems that currency undervaluation could easily be curbed by the application of this provision; all that would need to be proven by the complainant is that 1) a contracting party has adopted an exchange action and 2) that exchange action frustrates the intent of the GATT. In reality however, the application of this article is far from simple, for numerous reasons.

First of all, the terms “exchange action” and “frustrate” have not been defined in the article or anywhere else in the GATT. Secondly, Article XV(4) has never been interpreted by a WTO dispute settlement panel or the Appellate Body, despite the fact that it has been evoked by parties to disputes. The provision represents a junction point in the jurisdiction of the WTO and the IMF, which no party is willing to rule upon for fear of upsetting the status quo that has been in place from the establishment of the Bretton Woods System and the GATT. To further complicate the interpretation, paragraph 9 of the article provides an exception which may (or may not) be evocable in situations that constitute a breach of Article XV(4).

The general rule for interpreting the text of WTO agreements is provided in Article 3.2 of WTO’s Understanding on Rules and Procedures Governing the Settlement of Disputes (“Dispute Settlement Understanding” or “DSU”). According to Article 3.2, the dispute settlement system serves to “clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law”. It has been established in WTO case law that Articles 31 and 32 of the Vienna Convention on the Law of Treaties (“Vienna Convention”) set out such customary rules of interpretation. In accordance with Article 31, which codifies the “general rule of interpretation”, words of a treaty provision are to be given their ordinary meaning, in their context and in light of the


treaty’s object and purpose.\textsuperscript{73} If the application of this article either leaves the meaning ambiguous or obscure or leads to a manifestly absurd or unreasonable result, recourse may be had to “supplementary means of interpretation”, i.e. preparatory work and the circumstances of the provision’s conclusion.\textsuperscript{74} The next sections aim to clarify the meaning of the paragraphs of Article XV in light of these rules of interpretation.

5.2.2 Exchange Action

In order to determine whether Article XV(4) could be applied in situations of currency undervaluation, attention must first be placed on the term “exchange action”: what does the term “exchange action” mean, and does that definition encompass currency manipulation?

In WTO case law panels and the Appellate Body have regularly turned to the dictionary definition of a term in order to determine its ordinary meaning.\textsuperscript{75} According to the Oxford Dictionary, “exchange” means “the changing of money to its equivalent in the currency of another country” or “a system or market in which commercial transactions involving currency, shares, etc. can be carried out within or between countries”.\textsuperscript{76} “Action” is given the definition “the fact or process of doing something, typically to achieve an aim” or “a thing done; an act”.\textsuperscript{77} These dictionary definitions suggest that “exchange action” covers acts related to the changing of money or a system in which commercial transactions involving currency can be carried out between countries. Currency manipulation involves policies (i.e. actions) that have the aim of affecting the exchange rate. Therefore, a plain language reading of Article XV(4) would support the interpretation that it covers currency undervaluation.

However, further examination of the term is necessary because interpretation cannot be based solely on the definition given in a dictionary. As was pointed out by the Appellate Body in the case \textit{US – Gasoline}, “dictionaries, alone, are not capable of resolving complex questions of interpretation, as they typically aim to catalogue \textit{all} meanings of words – be

\textsuperscript{73} It has been established in WTO case law, for example \textit{US – Shrimp} ¶114, that there is a hierarchy established not only between VCLT Articles 31 and 32, but also inside Article 31: the object and purpose of the provision are to be taken into consideration only after interpreting the words’ meaning in their context. See Matsushita, Mitsuo, Schoenbaum, Thomas J. and Mavroidis, Petros C.: \textit{The World Trade Organization: Law, Practice, and Policy}, Second Edition, New York (2006) at 29-30.

\textsuperscript{74} Vienna Convention on the Law of Treaties, Article 32.

\textsuperscript{75} Appellate Body Report, \textit{US – Gambling} at ¶164; Panel Report, \textit{US – Section 301 Trade Act} at ¶7.22.


those meanings common or rare, universal or specialized”. Therefore, in accordance with Article 31 of the Vienna Convention, we must to turn to examine the context of the term “exchange action”.

According to some scholars, the context of the provision suggests that the term was meant to be given a broad meaning. This conclusion can be reached by examining terms related to exchange used in the GATT. Article XV(2) refers to “foreign exchange arrangements” and “exchange matters”, whereas XV(9) refers to “exchange controls or exchange restrictions”. Additionally, Ad Note to Articles VIII(1) mentions “multiple rates of exchange”, “multiple currency practices” and “multiple currency exchange fees” and Ad Note to Article XVI Section B also mentions “multiple rates of exchange”. The use of these terms shows that the drafters of the GATT were familiar with exchange related terms and, had they wished to limit the applicability of Article XV(4), they could have used a more specific term instead of the general one “exchange action”.

Other scholars, however, have argued that Article XV(4) must be read in conjunction with the IMF Articles of Agreement, in which case the term “exchange action” would include “exchange policies” and “exchange measures” but not “exchange rate policies”. According to Denters and Koops, “exchange measures” and “exchange policies” refer to “convertibility”, which means the exchange of one country’s currency into another currency. The IMF Articles of Agreement impose the obligation not to restrict the convertibility of currencies used for current transactions, that is, payments for goods or services. “Exchange rate policies” or “exchange rate measures” on the other hand concern the value of a currency: how many units of the local currency are equal to one unit of a currency.

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Despite these cases, the Appellate Body’s manner of interpreting the provisions of WTO agreements has generally been extremely literal and narrow, placing great emphasis on single words. For an interesting discussion on the judicial policy of the Appellate Body on interpretation and historical reasons behind it, see Abi-Saab, Georges: ‘The Appellate Body and Treaty Interpretation’, in Sacerdoti, Giorgio, Yanovich, Alan and Bohanes Jan (ed.): The WTO at Ten: The Contribution of the Dispute Settlement System, Cambridge (2006) at 453–473.


foreign currency, or the other way around. The IMF Articles of Agreement do not obligate member states to set the value of their currency at a certain level and states are allowed to freely determine the exchange rate policy it wants to apply.\(^82\)

Considering that Article XV governs exchange arrangements, which are under the IMF’s jurisdiction, it makes sense to give the terms of GATT Article XV meanings consistent with those of the terms in the IMF Articles of Agreement. A consistent interpretation of terms used in both agreements is useful keeping in mind the cooperation obligations between the two organizations that are established in GATT Article XV(1) and XV(2), which is why this approach can be considered commendable.

However, this approach to interpretation has also been criticized, because it is based on documents outside the WTO agreements.\(^83\) Indeed, an interpretation of a GATT provision based on the use of a term in IMF documents could be seen as inconsistent with the customary rules of interpretation of public international law because it takes the term out of its context in WTO law. It must be taken into consideration, however, that both panels and the Appellate Body have continuously made use of interpretative elements that are not included in the WTO covered agreements, e.g. acts adopted by various international organizations as well as decisions by international courts.\(^84\) Considering that Article XV(4) explicitly makes reference to the Articles of Agreement of the IMF, it would seem rather logical for a WTO panel or the Appellate Body to make use of IMF materials in the interpretation of the terms of the provision.

The extremely narrow interpretation presented by both Denters and Koops could also be said to disregard the object and purpose of the Article XV(4). The purpose of the Article is to guarantee that member states do not circumvent their obligations under the GATT by adopting measures that have negative trade effects but that are under the jurisdiction of the IMF and not the WTO. It might seem discrepant to interpret the provision in such a narrow manner that it would, simply due to a technical interpretation of the term “exchange

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action”, exclude from the scope of application of Article XV(4) exchange rate action that frustrates the intent of the GATT.  

Several academics have also pointed out that the preparatory work of the article provides evidence that exchange rate policies were intended to be included in the scope of the article. At the time of the drafting of the GATT, “manipulation” of the par value of a currency was a well-known and commonly used method of protecting domestic markets by limiting the amount of imports. According to Jackson, the drafters of the GATT “felt constrained to include some protection against them in the tariff agreement, even though the International Monetary Fund articles contained some similar provisions”.

Now that the par value system has been ended and states are freely allowed to not only choose the currency arrangement (pegged, freely floating, crawling peg etc.) but also determine their currency’s value, the risk of states manipulating their currencies is even higher than it was during the par value system. Therefore the need to be able to curb such action under the WTO system is even more accentuated than it was at the time GATT Article XV(4) was drafted and the arguments put forth by the drafters are still more than valid.

On the other hand, Zimmermann makes a convincing argument that the circumstances regarding the negotiation of the article support the interpretation that it is “unlikely this provision could serve as an independent basis for a WTO claim against maintaining an undervalued real exchange rate, especially in a dispute between two WTO members … that are both also members of the IMF”. According to Zimmermann Article XV(4) was introduced in order to protect GATT contracting parties in situations where other contracting parties were not members of the IMF and had for some reason been granted an exemption from making a special exchange arrangement with the Fund in accordance with GATT Article XV(6). Article XV(4) was therefore meant to cover “the potentially

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88 Article XV(6) reads as follows: Any contracting party which is not a member of the Fund shall, within a time to be determined by the CONTRACTING PARTIES after consultation with the Fund, become a
extended periods of time during which no special exchange arrangement is in place between the WTO and a member that is not yet or no longer a member of the IMF.” If this were the correct reading of the Article, it could not be invoked as a basis for a WTO claim by the United States against China in the currency undervaluation dispute, seeing as both are members of the IMF. However, as Zimmermann himself points out, the issue remains “speculative” as long as there is no WTO case law on the article.\footnote{Zimmermann, Claus D.: ‘Exchange Rate Misalignment and International Law’, 105 American Journal of International Law (2011) at 470-471; Jackson, John: World Trade and the Law of the GATT, United States of America (1969) at 479-482.}

In conclusion, it must be said that either a narrow or a wider interpretation of the term “exchange action” is possible. Whether or not the scope of Article XV(4) covers exchange rate action and therefore currency undervaluation, remains to be determined by future case law or a specific WTO agreement or declaration on the subject. For the sake of this paper, the following analysis parts from the presupposition that “exchange action” includes currency undervaluation and that Article XV(4) is generally applicable to situations such as the case of China.

5.2.3 Frustrating the Intent of GATT provisions

Article XV(4) provides that contracting parties “shall not, by exchange action, frustrate the intent of the provisions of this Agreement”. Even if the precise meaning of “exchange action” was determined, this provision leaves open two more questions: what is the “intent” of provisions of the GATT and what amounts to the “frustration” of that intent? Ad note to Article XV(4) provides that “the word ‘frustrate’ is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article.” This phrase, and the two examples that follow it, seem to signify that in order for there to be a frustration of the intent of the GATT, there must be a breach of the letter of a specific article and additionally an “appreciable departure” from the intent of that single article. However, the ad note starts

\footnote{Zimmermann, Claus D.: ‘Exchange Rate Misalignment and International Law’, 105 American Journal of International Law (2011) at 471.}
off with “for example”, which would seem to indicate that it is possible “frustrate” the provisions of the GATT also in other ways. According to Zimmermann, the words “for example” serve only to indicate that the same interpretation must be applied analogously to trade action frustrating the intent of the Articles of Agreement of the IMF. This is one possible interpretation, but it is not foreclosed that the example given in the ad note is indeed just an example, and that other manners of “frustrating the intent of the GATT” are possible. For example, it could be possible that the provision would cover a situation where there is no explicit breach of a specific provision, but nonetheless “frustration of the intent” of a single provision or perhaps even of the GATT as a whole.

Starting off with the first interpretation, it seems unlikely that currency undervaluation could be found to breach the “letter” of a specific GATT provision in addition to frustrating the intent of that provision. It is much more likely that maintaining an undervalued currency be considered a frustration of the intent of a provision without there being an actual violation of the provision in the strict sense. For example Paragraph 3 of Article II on tariff concessions provides that “no contracting party shall alter its method of determining dutiable value or converting currencies so as to impair the value of any of the concessions”. Asserting that maintaining an undervalued currency is a violation of the letter of this article would be somewhat farfetched. However, it could easily be said to frustrate the intent of this article, which is that tariff concessions should not be distorted by measures that indirectly affect the value of the concessions agreed to. As Staiger and Sykes put it

“[T]he heart of the GATT bargain has always been the market access commitments associated with the tariff bindings under Article II. A powerful argument can be made that any exchange action that frustrates these market access commitments would qualify as a potential violation under Article XV.”

Another important WTO rule that an undervalued currency clearly frustrates the intent of is the general prohibition on export subsidies, which is codified in Article 3 of the Agreement on Subsidies and Countervailing Measures. The problem in this case is that it is an open

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question whether the phrasing “provisions of this Agreement” covers only the provisions of the GATT or can be interpreted to cover other WTO Agreements which did not exist at the time of the drafting of the GATT. The general prohibition on export subsidies is not found in the text of the GATT itself but in a subsequent agreement, and therefore it is unclear whether “frustrating the intent” of the relevant SCMA provision could be interpreted as a breach of GATT Article XV(4).

However, even if the interpretation of the phrasing “provisions of this Agreement” in GATT Article XV(4) was limited to the provisions only of the GATT itself, it could easily be argued that intent of the original provision on subsidies, GATT Article XVI, is frustrated by an undervalued currency that functions as an export subsidy. Article XVI only prohibits export subsidies that result in the sale of a “product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market”. It focuses on the trade effects of export subsidies, instead of banning them outright. If it can be proven that an undervalued currency lowers the prices of products for export compared to the prices of the same products in the domestic market, the intent of this provision is frustrated and there is potentially a violation of Article XV(4) of the GATT.

The third possible interpretation brings Article XV(4) close to the non-violation complaint possibility given in Article XXIII, entitled Nullification or Impairment. This interpretation of Article XV(4) would be that it is sufficient that the intent of the GATT as a whole is frustrated, without there being an explicit violation of any single provision. According to the Oxford Dictionary, “intent” is an “intention or purpose”. Therefore, it could be argued that the “intent” of the GATT can be found in its preamble, which describes the purpose of the agreement. Based on the preamble, the purpose of the GATT could be said to be “raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand” or, more specifically, “the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce”. The intent of the GATT could also be interpreted to be a more legal one, such as the stipulation of “articulated rules of conduct for commercial transaction so that the bargained competitive conditions for


94 Muller, Carolina, Ramos, Daniel and Thorstensen, Vera: ‘The “Missi...
members’ markets are not arbitrarily disturbed”.\textsuperscript{95} The Appellate Body stated in the case \textit{EC – Computer Equipment}, that the “object and purpose of the GATT is “the security and predictability of ‘the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade’”.\textsuperscript{96}

Either way, the intent of the provisions of the GATT as a whole is not only hard to determine but also extremely abstract. Taking into consideration that the dispute settlement system of the WTO may not add to or diminish the rights and obligations of the covered agreements,\textsuperscript{97} an interpretation of Article XV(4) that allows for the declaration of a violation based on such an abstract idea of “intent” does not seem plausible or recommendable. As Jung accurately points out, “ruling currency manipulation illegal based on such broad interpretation and abstract consequence would face a serious legal challenge, especially since controlling the value of a currency falls within the sovereign right of a state”.\textsuperscript{98}

In the end, the interpretation of “frustration of the intent of the provisions of the GATT” can be interpreted in two ways. Either its purpose is to widen the possibility of making an exchange-related claim under the WTO, by making it possible to contest an exchange measure under the GATT if it frustrates the intent of a GATT provision even though there is no explicit breach of the letter of the provision. Alternatively, it could be intended to narrow the possibilities of finding that an exchange measure is in violation of the GATT by requiring that in addition to the necessary element of an explicit violation of the letter of a GATT provision, there must be an appreciable departure from the intent of the provision. It is therefore unclear whether the article could be invoked by a WTO member as the basis for a claim in a dispute concerning undervalued currencies.

\textbf{5.3 GATT Article XV(9)}

Paragraph 9 further complicates the interpretation of Article XV by introducing an exception which declares that nothing in this Agreement shall preclude the use by a

\begin{itemize}
\item \textsuperscript{96} Appellate Body Report, \textit{EC – Computer Equipment} at ¶82.
\item \textsuperscript{97} Dispute Settlement Understanding, Article 3.2 \textit{in fine}.
\end{itemize}
contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund. This provision establishes that as long as exchange controls or exchange restrictions are consistent with the member’s obligations under the IMF, there can be no violation of the GATT. What is unclear, however, is whether this exception applies also to Article XV(4); that is, whether XV(4) is lex specialis and therefore prevails over the exception in XV(9) or vice versa. Academics have presented that XV(9) is more specific and therefore takes precedence over XV(4). Siegel and Zimmermann both argue that XV(9) is more specific because it refers to “exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund”, whereas XV(4) refers to the much more general term “exchange action”. Moreover, Siegel argues that the negotiating history of the GATT also supports this interpretation, because the qualifying words “subject to the provisions of paragraph 4 of this Article”, which were included in the first draft of the GATT were deliberately deleted from the final text of this article. It would appear, therefore, that Article XV(9) provides an exception to the general rule set out in Article XV(4) that exchange actions that frustrates obligations and commitments under the GATT are prohibited.

Whether or not the exception provided for in Article XV(9) could be invoked to justify the maintaining of an undervalued currency remains yet to be determined, since no formal interpretation of the relationship between the paragraphs of the article has been made. According to Jackson, a special sub-group to the Ninth Session of the GATT Contracting Parties discussed the relationship between the two paragraphs, but instead of giving an interpretation of it, decided to leave it to “empirical consideration if and when the

99 GATT Article XV(9)a.
103 Miranda, Jorge: ‘Currency Undervaluation as a Violation of GATT Article XV(4)’, in The U.S.-Sino Currency Dispute: New Insights from Economics, Politics and Law (Simon Everett, ed.) London (2010) at 118. Miranda also points out that this exception is not one of a kind, but that the GATT includes another two similar exceptions regarding IMF consistency. These can be found in Ad Notes to Articles VI (on multiple currency exchange fees used for balance-of-payments purposes) and XVI (on multiple currency practices).
particular points arose which had a bearing on it”. 104 In the case Dominican Republic – Cigarettes, China requested the panel to clarify the relationship between paragraphs XV(4) and XV(9)105, but unfortunately the panel found it unnecessary to address the issue.106

If the exception embodied in Article XV(9) were determined to be applicable to situations which fell under GATT Article XV(4), the next step would be to determine what the phrase “exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Fund” actually encompasses. Since only “exchange controls” and “exchange restrictions” are covered by the exception, it must be concluded that exchange actions other than these could constitute a violation of GATT XV(4), even if they were in accordance with the IMF Articles of Agreement.107

Ahn has argued that “exchange controls or exchange restrictions” do not include exchange policies. According to Ahn, Article XV(9) refers to exchange controls or restrictions on convertibility that have been “permitted by specific decisions made by the IMF as special measures to address balance of payment problems of its members” and that “a grand scale exchange-rate policy” adopted by a state in order to fix the value of its currency would not be covered by this exception.108

On the other hand, Zimmermann attests that the measures customarily taken by a state in order to maintain an undervalued currency, that is, capital controls, surrender requirements, the channeling of payments through the banking system and increased reserve requirement, could well amount to exchange restrictions or exchange controls in the sense of Article XV(9).109 A more in-depth interpretation Article XV(9) requires an examination of the IMF Articles of Agreement, specifically Articles VI and VIII thereof, which ultimately deal with exchange controls and exchange restrictions.

Article VI, titled Controls of Capital Transfers, provides that member states are generally allowed to “exercise such controls as are necessary to regulate international capital

105 Panel Dominican Republic – Cigarettes at ¶5.58.
movements”, except when they are exercised “in a manner which will restrict payments for current transactions” unless the IMF has given its approval.\footnote{110} Therefore, if the measures implemented by a state in order to achieve or maintain an undervalued currency include restrictions on payments for current transactions, these measures require explicit consent from the IMF, or else they are inconsistent with the Articles of Agreement and accordingly not justified under GATT Article XV(9).

As for exchange restrictions, the relevant IMF Article VIII:2(a) provides that “no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions”. In the case Dominican Republic – Cigarettes, the panel referred to a 1960 IMF Executive Board Decision on Articles VIII and XIV, in which the meaning of this provision is clarified, and stated that this definition should be respected when interpreting GATT Article XV(9).\footnote{111} The decision declares that the “guiding principle” in ascertaining whether a measure is a restriction in the sense of Article VIII:2(a) “is whether it involves a direct governmental limitation on the availability or use of exchange as such”.\footnote{112} Determining whether a measure amounts to an exchange restriction is therefore based on a purely technical criterion and the reason why the restrictions have been implemented (e.g. maintaining a currency at a certain value or other exchange policy-related purposes) is completely irrelevant.\footnote{113} Consequently, exchange restrictions implemented in order to maintain an undervalued currency are inconsistent with the IMF Articles of Agreement and would not be included in the scope of GATT Article XV(9), unless they have been expressly authorized by the IMF.\footnote{114} Interpreting Article XV(9) in this way allows for the legal discussion to be shifted from the politically extremely sensitive (and essentially inoperative) IMF Article IV(1)iii to the more technical issues behind currency manipulation.\footnote{115}

\footnote{110} IMF Articles of Agreement, Article VI Section 3.

\footnote{111} Panel Dominican Republic – Cigarettes at ¶7.132.

\footnote{112} IMF Executive Board Decision No. 1034-(60/27), June 1, 1960, in Selected Decisions and Selected Documents of the International Monetary Fund, Thirty-sixth Issue, Washington DC (2011).


\footnote{115} Muller, Carolina, Ramos, Daniel and Thorstensen, Vera: ‘The “Missing Link” between the WTO and the IMF’, Journal of International Economic Law 16(2) at 377.
The final difficulty in applying Article XV(9) is that it requires an assessment of the measures in question not only in the light of the GATT, but also under the IMF Articles of Agreement, which requires consultations with the IMF.

5.4 Procedural Link: Consultations with the IMF Under Article XV(2)

5.4.1 Does the Obligation Extend to Dispute Settlement Proceedings?

Article XV(2) provides that contracting parties shall consult fully with the International Monetary Fund in matters concerning monetary reserves, balances of payments or foreign exchange restrictions and in such consultations “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”.

The provision not only obligates the WTO to consult with the IMF, but also to accept certain determinations provided by the Fund. These determinations can be divided into factual (often statistical) findings concerning for example monetary reserves and balance of payments, and legal findings, which concern the legality of measures with the Funds’ Articles of Agreement. Whereas factual findings serve to provide the panel the information it needs in order to apply certain provisions, for example the balance of payments exception established in Article XII of the GATT, legal findings serve to avoid cross-conditionality between WTO and IMF obligations.

Although Article XV(2) seems to establish a clear obligation, it is somewhat ambiguous to whom this obligation extends. In particular, what remains to be determined is whether the obligation covers dispute settlement proceedings. The issue was debated at length by USA and India before the panel in the case India – Quantitative Restrictions. Although in this case the question regarded India’s balance of payments, the arguments concerning the role of the IMF and its findings in the dispute settlement procedure are equally applicable to a case concerning exchange arrangements.

The United States argued that in accordance with the incorporation clause of the GATT in the WTO Agreement, the term “contracting parties” refers to the WTO, and the WTO includes panels. The United States concluded that the panel should consult the IMF if it “had any doubts”. The United States presented the convincing argument that if the obligation of Article XV(2) did not extend to panels, they would be less constrained by GATT rules than other WTO bodies, which could lead to inconsistency between panels and the rest of the WTO.  

India, on the other hand, was of the opinion that the interpretation of GATT XV(2) presented by the United States ignores the division of functions between the various bodies of the WTO. India presented the opposite view, claiming that the obligations established in the provision do not extend to panels.

Instead of taking the opportunity to resolve this issue, the panel chose to avoid taking a stance by stating that it did not find it necessary to determine whether Article XV(2) requires panels to consult with the IMF. The panel opted, instead, to consult the IMF under Article 13 of the Dispute Settlement Understanding, which provides that each panel “may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter”. The panel stated that “whatever the interpretation of Article XV:2 of GATT 1994, Article 13.1 of the DSU entitles the Panel to consult with the IMF in order to obtain any relevant information relating to India's monetary reserves and balance-of-payments situation which would assist … in assessing the claims submitted”. Since this finding of the panel’s decision was not appealed, the Appellate Body found it unnecessary to address it in its report.

A more recent case, Dominican Republic – Import and Sale of Cigarettes, placed the panel in the situation to interpret the article yet again, this time specifically in order to determine whether the exception provided in GATT XV(9) was applicable to the measures at hand in the dispute. Given a second chance, the panel did not take the easy way out, but

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117 Panel Report, India – Quantitative Restrictions at ¶3.309.
118 Panel Report, India – Quantitative Restrictions at ¶5.11.
120 Appellate Body Report, India – Quantitative Restrictions at ¶152.
121 Panel Report, Dominican Republic – Import and Sale of Cigarettes at ¶7.139.
consulted the IMF on the basis Article XV(2) for the first (and so far only) time in the history of the WTO.\textsuperscript{122}

The panel considered it necessary to consult with the IMF based on Article XV(2), because the Dominican Republic argued that its imposition of the import charges and fees was an exchange restriction that was in accordance with the Articles of Agreement of the IMF, and therefore justified under Article XV(9)\textsuperscript{123}. The panel therefore requested the IMF to provide information on whether the measure taken by the Dominican Republic was an "exchange control" or "exchange restriction" under the Articles of Agreement of the IMF.\textsuperscript{124} In its reply, the IMF stated that the measure did not “constitute a multiple currency practice or an exchange restriction” and was “no longer subject to Fund approval”.\textsuperscript{125} Taking this into consideration, the panel concluded that the measure did not constitute an “exchange restriction” within the meaning of Article XV(9) and was therefore not justified.\textsuperscript{126}

Although the panel decided to consult the IMF and accept its findings in accordance with GATT Article XV(2), the report did not shed light on the correct interpretation of this provision, i.e. whether the panel was under the obligation to do so. The panel consulted the IMF because it “needed to seek more information” and for this reason “needed to consult with the IMF based on paragraph 2 of Article XV”. The language of the panel’s report leaves open the question of whether the panel would have been under the obligation to consult the IMF had it considered that it did not need further information.\textsuperscript{127} As Zimmermann points out, “it appears to have reasoned exactly as if it were proceeding on the basis of its discretionary authority under DSU Article 13”.\textsuperscript{128} In fact, the reasoning of the panel in \textit{Dominican Republic – Cigarettes}, rather contradictorily, actually seems to

\begin{thebibliography}{9}
\bibitem{123} Panel Report, \textit{Dominican Republic – Import and Sale of Cigarettes} at ¶7.139.
\bibitem{124} Panel Report, \textit{Dominican Republic – Import and Sale of Cigarettes} at ¶7.142.
\bibitem{125} Panel Report, \textit{Dominican Republic – Import and Sale of Cigarettes} at ¶7.144.
\bibitem{126} Panel Report, \textit{Dominican Republic – Import and Sale of Cigarettes} at ¶7.145.
\bibitem{127} Zimmermann, Claus D.: ‘Exchange Rate Misalignment and International Law’, 105 \textit{American Journal of International Law} (2011) at 462.
\bibitem{128} Zimmermann, Claus D.: ‘Exchange Rate Misalignment and International Law’, 105 \textit{American Journal of International Law} (2011) at 462.
\end{thebibliography}
support the interpretation that Article XV(2) does not obligate the panel to consult with the IMF, but leaves the matter to the panel’s discretion. Such an interpretation, however, would seem to be contrary to the ordinary meaning of the words of the provision: “shall consult” and “shall accept”. Since the panel consulted the IMF under Article XV(2), and not under DSU Article 13, it is implied that the panel deemed itself to be covered by the term “contracting parties”, which refers to the WTO.\(^\text{129}\) If this is the case, the panel would have been obligated under Article XV(2) to consult the IMF and accept its findings, and such a decision could not have been simply the result of the panels’ discretion. It would seem, therefore, that the only logical interpretation of the report of the panel is to conclude that, despite the fact that the panel did not explicitly so articulate when wording its decision, Article XV(2) does obligate panels, and therefore also the Appellate Body, to consult the IMF and accept its findings in the matters listed in the provision.

An issue that has been brought up by commentators in relation to this particular aspect of Article XV(2) is the apparent conflict between the obligation of the panel to accept as dispositive the determination of the IMF and, on the other hand, Article 11 of the DSU, which requires the panel to make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements. Siegel argues that these obligations can be reconciled by assessing them in light of DSU Article 3.2, which provides that rulings of panels may not add to or diminish the rights and obligations provided in the covered agreements. In the words of Siegel, “[E]xcluding the panel from the consultation requirement would change the substantive effect of the instruction in the GATT precisely in the circumstances where these substantive rules are being applied to determine compliance with the agreements”\(^\text{130}\).

This question was discussed at length before the Appellate Body in *India – Quantitative Restrictions*, in which India claimed that the panel had acted inconsistently with the obligation of Article 11 of the DSU by “delegating to the IMF its duty to make an objective assessment of the matter”.\(^\text{131}\) The Appellate Body found that the claim that the panel had “delegated its judicial function to make an objective assessment of the matter” to

\(^{129}\) GATT 1994 explanatory note 2(b).


\(^{131}\) Appellate Body Report, *India – Quantitative Restrictions* at ¶146.
the Fund was not supported by anything in the panel report. According to the Appellate Body, the panel had not simply accepted the IMF’s views but rather had “critically assessed” them and “also considered other data and opinions in reaching its conclusions”, and therefore had not acted inconsistently with DSU Article 11.

Another extremely valid point presented by Siegel is that the inclusion of the DSU in the WTO Agreements “should not be interpreted in a way that changes the relationship between the Fund and the WTO”. If the obligation provided in Article XV(2) were to be interpreted not to extend to panels, it would mean that the institutional relationship between the IMF and the WTO, as it was established in the GATT 1947, would have been changed by the establishment of the dispute settlement system of the WTO. As Siegel points out, it would be rather inadvisable to leave such an important and far-reaching decision to be made by the interpretation of a panel.

5.4.2 Legal Findings

Whether or not the obligation of Article XV(2) applies to panels as well as to other WTO bodies, the next step is to determine what sort of statement is required from the IMF in order for the panel to be able to conclude that a measure is inconsistent (or in accordance) with the IMF Articles of Agreement. Is it necessary for the Fund to state outright that there is a violation of its Articles of Agreement, or does it suffice that the Fund states indirectly that a measure is perhaps not completely consistent with the member’s obligations under the IMF. Must the statement be an official one made by the Executive Board of the Fund or is for example a statement drafted by the staff sufficient? What if the reply of the IMF is ambiguous and does not explicitly state whether or not the measure is in accordance with the Articles of Agreement? These questions could be of pivotal importance when considering the reason why a case of currency undervaluation would be brought before the WTO instead of the IMF in the first place; namely the difficulties in applying Article IV(1)(iii) of the IMF Articles of Agreement. If, in order to apply Article XV(4), the panel

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132 Appellate Body Report, *India – Quantitative Restrictions* at ¶149.
133 Appellate Body Report, *India – Quantitative Restrictions* at ¶151.
136 See section 3.2 of this paper on IMF Article IV(1)(iii).
would first have to determine that the exception provided in Article XV(9) did not apply, and this required a formal statement from the IMF’s Executive Board that Article IV(1)iii was breached, the essential inoperativeness of the Article would be introduced into the WTO system and the parties would be brought back to square one. Fortunately, as was discussed above, it is not inevitably necessary for a breach of Article IV(1)iii to be found in order for Article XV(9) not to apply. Although based on the titles of the two articles, there is a clear link between Article XV of the GATT (Exchange Arrangements) and Article IV of the IMF Articles of Agreement (Obligations Regarding Exchange Arrangements), a state that frustrates the intent of the GATT does not necessarily have to be a currency manipulator in the sense of Article IV(1)(iii). In order for the measure to fall outside the scope of the justification provided in Article XV(9), it suffices that it is not “in accordance with” the IMF Articles of Agreement, i.e. that it breaches any article of the Articles of Agreement. Since the measures implemented by states in order to maintain an undervalued currency are manifold, they may fall under various provisions of the IMF Articles of Agreement, for example Articles VI and VIII, which regard exchange controls and exchange restrictions. Nevertheless, the nature of consultations with the IMF, namely what sort of reply is required and from whom, can play an important role in applying Article XV(9).

According to Siegel, the reference in Article XV(2) to “the International Monetary Fund” means formal contact on an institutional level, and in this context, refers to the Executive Board. A response to a request from the WTO would be drafted by the staff, but subject to the Board’s approval before being submitted on behalf of the Fund. The Executive Board is composed of 24 Directors, who are appointed or elected by member countries or groups of countries and thus represent these countries’ views.

In the case *Dominican Republic – Cigarettes*, the panel reached the conclusion that the foreign exchange fee implemented by the Dominican Republic was not justified under GATT XV(9), even though the IMF had not in its reply determined whether the measure

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137 See section 5.3 of this paper on Article XV(9).
was in accordance with the Fund’s Articles of Agreement.\textsuperscript{141} Since consultations with the IMF did not give an answer to the question, the panel turned to analyze, albeit on an arguendo level, whether the Dominican Republic had discharged its burden of proof in demonstrating that the measure is “in accordance with” the IMF Articles of Agreement.\textsuperscript{142} The panel concluded that the IMF news release, in which the IMF informed of its waiver decision, provided by the Dominican Republic as proof, did not demonstrate that the measure was “in accordance with” the IMF Articles of Agreement.\textsuperscript{143} Although the issue addressed by the panel in this situation was not only the form in which the IMF’s statements on the measure at question were provided to the panel, but also their substance, the interesting aspect of this case is that the panel apparently considered itself competent to examine the IMF-consistency of the measure without an explicit statement in this regard from the IMF itself.\textsuperscript{144}

The reasoning of the panel in this case seems to establish the possibility for a panel to rather independently assess whether a measure is consistent with the Fund’s Articles of Agreement, provided that such a determination is necessary for the application of GATT Article XV(9) and the IMF has not, for some reason or other, provided the panel with its own determination regarding consistency during the consultations held under GATT Article XV(2).

5.4.3 Factual Findings

The relevancy of Article XV(2) in interpreting Article XV(4) is not, however, limited to situations to which the exception provided in Article XV(9) is applicable and findings of a legal nature provided by the IMF are necessary. Even in the scenario that Article XV(4) was deemed \textit{lex specialis} and Article XV(9) was therefore not applicable, or if the measures in question were interpreted not to constitute “exchange controls” or “exchange restrictions” and were therefore not covered by paragraph 9, consultation with the IMF


\textsuperscript{142} Panel Report, \textit{Dominican Republic – Cigarettes} at ¶7.151.

\textsuperscript{143} Panel Report, \textit{Dominican Republic – Cigarettes} at ¶7.152-7.154.

might nevertheless be necessary in order to obtain the factual findings required to make an appropriate assessment of the exchange measures in question.

Article XV(2) provides that in cases in which the WTO is called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, it shall accept all findings of statistical and other facts presented by the Fund. As part of its activities, the IMF regularly collects and analyzes statistical and other data relevant to its surveillance and other activities. The function of consultation in these matters is to make use of the IMF’s special expertise in acquiring the data necessary for the WTO to make a legal assessment of the matter at hand.145

In a case concerning currency undervaluation, the statistical findings required by the panel in order to assess the matter would be for example related to what the value of the currency would be if it was allowed to float freely and the maintained exchange rate’s level of misalignment compared to this value, or statistical findings related to the interventions made by the central bank on the currency market, etc. Zimmermann lists the following as the most notable possibilities of actions taken in order to achieve and maintain an undervalued exchange rate: capital controls combined with sterilization, surrender requirements for export earnings, increased reserve requirements, and price controls.146 In most cases such measures and their effects would probably be deemed to fall under “problems concerning monetary reserves, balances of payments or foreign exchange arrangements” and thus under the consultation obligation.

When the panel consults with the IMF concerning factual findings, it must be stressed that these consultations do not in any way change the obligations of the panel or the parties to the dispute under the Dispute Settlement Understanding. In India – Autos, the panel stated that “[I]t is clear that a panel’s fact finding mandate should not be utilized so as to make out a prima facie case where that is not achieved by the relevant party.” In the case, India had failed to make a prima facie case that its balance of payments situation was such as to justify measures under GATT Article XVIII:B. Instead, it had indicated that it expected the panel to consult the IMF in determining India’s balance of payments situation. The panel stated that at an appropriate stage in proceedings, such consultations could be helpful in


determining whether India’s measures were justified under Article XVIII:B, but that the arguments presented by India “did not even lead the panel to that point”.

The panel’s obligation to make an objective assessment of the matter in accordance with DSU Article 11 was already discussed above. In the case of factual findings it is clear that consultations with the IMF do not put at risk the panels’ objective assessment of the matter, but rather serve to provide the necessary statistical and other factual information in order to make such an assessment. Although under Article XV(2) the panel is under the obligation to “accept all findings” presented by the IMF, it must still make an objective assessment of whether, based on these findings and those provided by the parties to the dispute, the measures in question are consistent with WTO provisions.

Even if the panel deemed itself not to be obligated under Article XV(2) to consult with the IMF, in a hypothetical case concerning currency undervaluation, it might still find it necessary, or simply useful, to do so under DSU Article 13 in order to fulfill its obligation of making an objective assessment of the matter. Under DSU Article 13, panels have the right to seek information and technical advice from any individual or body which it deems appropriate. In India – Quantitative Restrictions the panel consulted the IMF based on this provision, stating that Article 13.1 of the DSU entitles the panel to consult with the IMF in order to obtain any relevant information relating to India’s monetary reserves and balance-of-payments situation which would be of assistance in assessing the claims submitted by the parties.

The significant difference in whether the panel consults the IMF under its general right to seek information under DSU Article 13 or the specific consultation obligation provided in GATT Article XV(2) is the panel’s discretion. Under DSU Article 13, the panel can freely decide whether to consult the IMF and also use its discretion in whether or not to accept the findings presented by the IMF. Under GATT Article XV(2), on the other hand, the panel has no discretion in deciding whether to consult the IMF, nor in accepting its findings.

This difference was illustrated in the case Argentina – Textiles and Footwear, in which the obligation provided in DSU Article 11, the panel’s right to seek information under DSU

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147 Panel Report, India – Autos at ¶7.294.
Article 13 as well as the obligation provided in GATT Article XV(2) were discussed. The Appellate Body first concluded that the case did not involve measures that required the panel to consult with the IMF under GATT Article XV(2).\(^\text{150}\) The Appellate Body stated that it “might perhaps have been useful for the panel to have consulted with the IMF”. However, contrary to the arguments presented by Argentina, the Appellate Body reached the conclusion that the panel acted within the bounds of its discretionary authority under Articles 11 and 13 of the DSU in deciding not to seek information from, nor to consult with, the IMF on the matter in question.\(^\text{151}\) Had the Appellate Body reached a different conclusion regarding the applicability of GATT Article XV(2), this would not have been the case.

5.5 From Overlapping Jurisdictions to a Loophole?

Already at the time of the founding of the IMF and the GATT system, it had been realized that trade and monetary measures are two sides of the same coin, and thus the competences of the two systems could not be clearly separated, nor would it make sense to try to do so. Instead, the systems were established in order to complement each other, and measures were taken to avoid cross-conditionality between the rights and obligations under both systems. In order to accomplish this, both substantial and procedural links were included in the GATT. The most important of these are provided in Article XV entitled Exchange Arrangements. This solution, the interpretation of which has been examined in detail above, is what Viterbo calls “regime borrowing”: the incorporation of IMF rules into trade treaties. The IMF regime on exchange restrictions was borrowed in its entirety into the GATT system, and with the Marrakesh Agreement, directly into the WTO almost five decades later.\(^\text{152}\)

The difficulties this “regime borrowing technique” brings with it are numerous, and have been discussed at length above. Although the procedural link provided in GATT Article XV(2) has been interpreted by the panel in recent cases, many other issues remain to be addressed by a competent authority, and are currently the object of speculation by

\(^{150}\)Appellate Body Report, Argentina – Textiles and Footwear at ¶84-85.

\(^{151}\)Appellate Body Report, Argentina – Textiles and Footwear at ¶86.

academics and politicians alike. In the face of such legal uncertainty, it seems that the majority have given up on Article XV and sought to address the problem of currency undervaluation under the WTO regime by other means. The most commonly proposed alternative is the WTO subsidies regime, and more specifically, the prohibition on export subsidies. It appears almost as though in the fear of creating overlapping jurisdictions between the two organizations and cross-conditionality for their members, the drafters might have in fact gone too far in the other direction, creating a loophole in international economic law, which is now being attempted to be filled in by stretching the interpretation of other provisions.
6  WTO Provisions on Subsidies

6.1 General

Although the only provision that explicitly deals with exchange arrangements is GATT XV, it might be possible to challenge exchange rate undervaluation through the WTO dispute settlement system under a few other provisions. The two most commonly mentioned articles currency undervaluation could be deemed to breach are GATT Article II, by nullifying the effects of tariff concessions, and the general prohibition on export subsidies, which is codified in the Agreement on Subsidies and Countervailing Measures. Since it is the most debated alternative, this paper will concentrate on whether an undervalued currency could be challenged as a prohibited export subsidy. Before analyzing in detail whether currency undervaluation could fulfill the criteria of a prohibited export subsidy, the history and general structure of the WTO provisions on subsidies will be given a cursory glance.

The two GATT provisions on subsidies can be found in Articles VI (anti-dumping and countervailing duties) and XVI (subsidies). The GATT’s approach on subsidies was relatively lenient, condemning only subsidies that were used in such a way as to cause material injury to the industry of another member state. Article XVI:4 provided for the gradual elimination of export subsidies for non-primary products. The most problematic aspect of the GATT provisions on subsidies was the absence of any form of definition of a subsidy. This was resolved only in 1995, which the establishment of the WTO and the introduction of the Agreement on Subsidies and Countervailing Measures.

The SCMA not only provided a definition for the term subsidy, but also divided subsidies into three categories (prohibited, actionable and non-actionable) and introduced detailed provisions on the administration of countervailing duties. As the Panel stated in Japan – DRAMS CVDs, the purpose of the SCMA is to apply and interpret the rules of the GATT

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154  The need for clearer rules governing subsidies was acknowledged well before the Uruguay Round, and indeed during the Tokyo round of 1973-1979, an agreement called the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement was concluded. This agreement, more commonly known as the Tokyo Round Subsidies Code, as not accepted by more than twenty-five Contracting Parties and did not provide the clarification on rules on subsidies that it was intended to provide, which led to a continuation of GATT disputes regarding subsidies and countervailing measures. See Van den Bossche, Peter: *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, New York (2005) at 552-553.
subsidy provisions and "elaborate rules for the application of GATT Articles on subsidies and dumping in order to provide greater uniformity and certainty in their implementation." Both agreements are integral parts of the WTO Agreement and constitute an inseparable package of rights and obligations, and must therefore be read in conjunction. Accordingly, after the SCMA came into force, GATT rules on subsidies can no longer be invoked independently.

6.2 Prohibited and Actionable Subsidies

The Agreement on Subsidies and Countervailing Measures introduced the concepts of prohibited, actionable and non-actionable subsidies. The provisions regarding non-actionable subsidies were subject to review after 5 years, and since they were not renewed in 2000, all subsidies now fall under the category of either actionable or prohibited subsidies.

The SCMA introduced two types of prohibited subsidies: local content subsidies and export subsidies. Article 3.1(a) prohibits subsidies that are contingent, either in law or in fact, upon export performance, whereas 3.2(b) prohibits subsidies that are contingent upon the use of domestic over imported goods. These subsidies are irrebuttably presumed to distort trade and are prohibited as such, which means that there is no need to demonstrate that they have adverse effects on trade. Actionable subsidies are generally permitted, but can be challenged if they are specific in the sense of Article 2 and cause adverse effects on trade.

6.3 Remedies

Both prohibited and actionable subsidies may be challenged either through the unilateral imposition of countervailing duties or through the multilateral dispute settlement procedure. If a subsidy is challenged via the multilateral system and deemed a prohibited subsidy, it must be withdrawn without delay and within the timeframe recommended by

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155 Panel Report, Japan – DRAMS CVDs at footnote 605.


the panel. In the event that the state does not remove the prohibited subsidy within the time-period given, the Dispute Settlement Body may grant the complaining party the right to take appropriate countermeasures. If the panel deems the subsidy an actionable subsidy with adverse trade effects, it can be either withdrawn or its adverse effects removed by taking countermeasures.

In order to unilaterally impose countervailing duties, the state challenging the measure must conduct an in-depth investigation in order to prove that the subsidized imports are causing injury to its domestic industry. The SCMA provides for detailed requirements regarding the conducting of the investigation, the calculation of the benefit granted by the subsidy, as well the determination of injury and the causal link between the subsidy and its effects on domestic industries.

### 7 Definition of a Subsidy

#### 7.1 General

One of the important novelties of the SCMA was the introduction of the definition of a subsidy. Article 1 functions as a “gateway” to the Agreement, in the sense that in order for the provisions of the Agreement to apply to a certain measure, that measure must fall under the definition of a subsidy provided in Article 1. In order to fulfill this definition, there must be 1) a financial contribution or income or price support from the government and 2) a benefit must thereby be conferred to 3) a limited group of recipients (specificity requirement). These elements are cumulative, and must all be present simultaneously in order for a subsidy in the sense of the SCMA to exist.

As will now be examined in more detail, it is extremely unlikely that currency undervaluation could be deemed to fulfill all three criteria of a subsidy.

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159 SCMA Art 4.7.
160 SCMA Art 4.10.
161 SCMA Part III and Part V.
7.2 Financial Contribution or Income or Price Support

7.2.1 Financial Contribution

7.2.1.1 General

The first criterion of a subsidy is that there is a financial contribution (or income or price support) from the government. Article 1.1(a)(1) lists four different forms of financial contribution: i) direct transfer of funds or potential direct transfer of funds, ii) government revenue otherwise due that is foregone or not collected, iii) government provided services or goods, and iv) a private body being entrusted by the government to perform one or more of the first three functions listed. The list of financial contributions provided in the article is exhaustive. This is clear from the actual wording of the article and has also been confirmed in case law.\textsuperscript{162} However, the items have been interpreted very broadly and cover a wide range of government measures, as examined in more detail below.

7.2.1.2 Government or any public body

According to Article 1.1(a)(1), the financial contribution must be from the government or any public body. In the case of an undervalued currency, the measures giving rise to the undervaluation are most often taken by the state’s central bank. In \textit{Korea – Commercial Vessels}, the Panel ruled that the Export-Import Bank of Korea is a public body based on the fact that it the Korean government has control over its decision-making. Although the finding that any entity controlled by the government is a public body was subsequently reversed by the Appellate Body in the case \textit{US – CVDs (China)}, a state’s central bank would most likely be considered a public body even following the new interpretation of the term given by the Appellate Body.

In the case \textit{US – CVDs (China)}, the Appellate Body differentiated between the term "government" in the narrow sense and the term in a collective sense, which refers collectively to the "government or any public body". In the SCM Agreement, the term "government" is used in the collective sense and therefore refers to both the government in the narrow sense as well as any public body. The Appellate Body also examined what

"essential characteristics" an entity must have in order to be part of the government in the collective sense. The conclusion reached was that a "public body within the meaning of Article 1.1(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority". The Appellate Body stressed that the characteristics of a public body vary from state to state and case to case, and the determination of whether an entity fulfills the definition should be based on an evaluation of the entity’s core features and its relationship with the government in the narrow sense.\textsuperscript{163}

The institutions implementing a state’s currency practice would to all appearances fulfill this definition and be considered part of the “government” in the collective sense.

7.2.1.3 Direct transfer of funds

The first form of financial contribution is when a government practice involves a direct transfer of funds, e.g. grants, loans and equity infusions. The term direct transfer of funds has been interpreted widely in WTO case law, and has covered for example debt-for-equity swaps and modifications of loan repayment terms\textsuperscript{164} as well as share transfers\textsuperscript{165}, in addition to actual payments.

The forms of direct transfer of funds cited (grants, loans and equity infusions) are given as examples and serve to show that measures that are similar to these are also covered by the provision. The Appellate Body has also stated that the concept of direct transfer of funds should not be interpreted in a manner too literal and mechanistic, and that it is not confined to situations where there is an incremental flow of funds to the recipient that enhances the recipient’s net worth.\textsuperscript{166}

Even so, it is extremely unlikely that an undervalued currency could be deemed to fit under subparagraph (i) of Article 1.1(a)(1). Firstly, there appears to be no government transaction similar to a grant, loan or equity infusion. It has been argued that an undervalued currency amounts to a direct transfer of funds because of the higher amount of domestic currency an exporter gets in exchange for its foreign currency. The amount of funds would be equal to the difference in the amount of domestic units of currency the exporter gets according to

\textsuperscript{163} Appellate Body Report, \textit{Japan – DRAMs CVDs} at ¶251.

\textsuperscript{164} Panel Report, \textit{Korea – Commercial Vessels} (unappealed) and Appellate Body Report, \textit{Japan – DRAMs CVDs (Korea)}.

\textsuperscript{165} Panel Report, \textit{EC – Large Civil Aircraft}.

\textsuperscript{166} Appellate Body Report, \textit{Japan – DRAMs CVDs} at ¶250-251.
the undervalued exchange rate and the amount it would get if the exchange were calculated according to a hypothetical non-manipulated exchange rate. However, the transfer of funds must be direct, which means “without intervening factors or intermediaries”. Since it is not the government itself exchanging the currency, but private banks, the transfer of funds cannot be deemed direct in this sense. Moreover, the entities exchanging the currency are merely doing so based on the exchange rate that has already been manipulated as a result of other measures taken by the government.

Manipulation of the exchange rate is achieved by influencing the amount of foreign and/or domestic currency on the currency market by purchasing or selling foreign and/or domestic currency. For example in the case of China, the undervaluation of the RMB is accomplished by issuing RMB and purchasing large amounts of foreign currency, namely US dollars, in order to alleviate pressure to appreciate the RMB. These measures actually causing undervaluation of the exchange rate are taken directly by the government and must be separated from the actual act of exchanging currency, which is put into action by private banks and confers a benefit to domestic exporters. Therefore currency undervaluation does not fulfill the element of financial contribution in the form of a direct transfer of funds.

### 7.2.1.4 Government provided services

Since challenging currency manipulation as government revenue otherwise due that is foregone or not collected is extremely far-fetched, the next item to be examine in more detail is item (iii) of Article 1.1(a)(1). According to item (iii) a financial contribution exists when the government provides goods or services other than general infrastructure. It has been discussed whether currency undervaluation could constitute a government provided

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service in the meaning that it saves exporters from the need to hedge against foreign exchange losses. The problems with this argument are manifold.

Firstly, an interpretation of this kind could be widened to mean that any kind of exchange regime other than a freely floating currency that reduces exchange rate risks would be considered a governmental service in the sense of Article 1.1(a)(1)(iii). As Zimmermann states, “it is safe to conclude that such an interpretation would go well beyond the intended scope” of the article.

Secondly, and more importantly, it is difficult to argue how an exchange arrangement is not part of “general infrastructure”. Dictionary definitions of the word infrastructure include “the underlying basic framework (as of a system or organization)” and “installations and services … regarded as the economic foundation of a country”. Currency arrangements are without a doubt part of a country’s monetary infrastructure and regarded as the economic foundation of a country.

The term general infrastructure has been interpreted in detail by the panel in the case EC – Aircraft. According to the panel’s reading, the existence of de jure or de facto limitations on access to or use of infrastructure is essential in determining whether it is “general” infrastructure or not, although also other considerations can be taken into account. In the case of currency undervaluation, it is indisputable that access to the exchange rate is not limited in any way, but rather is available to (and obligatory for) everyone. The fact that exporters are the ones actually gaining benefits from it is not relevant in the evaluation of whether a financial contribution under Article 1.1(a)(1) exists.


174 Panel Report EC – Aircraft at ¶7.1036-7.1044. The reasoning of the panel in these paragraphs was not commented on by the Appellate Body in its subsequent report (Appellate Body Report EC – Aircraft at ¶968).

175 Panel Report EC – Aircraft at ¶7.1036.
7.2.1.5 Private body entrusted to perform functions (i)-(iii)

Article 1.1(a)(1)(iv) is in essence an anti-circumvention provision that was introduced in order to prevent member states from escaping responsibility for their actions by delegating functions listed in (i)-(iii) to private bodies.\textsuperscript{176} It covers situations where a government makes payments to a funding mechanism or uses a private body as a proxy in order to make a financial contribution.\textsuperscript{177}

It might be possible to argue that in the case of currency undervaluation, private banks are entrusted by the government to exchange currency at an undervalued rate which gives rise to a financial contribution. The issue with this interpretation is that it would first have to be determined that the exchange of currency constitutes one of the forms of financial contribution listed in subparagraphs (i)-(iii). In the hypothetical situation that the panel was to deem that a state’s currency manipulation resulted in a financial contribution in one or more of the forms listed in (i)-(iii), it would most probably come to the conclusion that private-owned banks exchanging currency at the undervalued exchange rate would fulfill the definition of indirect financial contribution in the sense of subparagraph (iv). However, as has just examined in the paragraphs above, it is extremely unlikely that a panel was to deem a financial contribution to exist in any form.

7.2.2 Distinction between financial contribution and benefit

The important distinction between the concepts of financial contribution and benefit has been stressed numerous times by both the panel and the Appellate Body\textsuperscript{178} and must be kept in mind when determining whether a government measure constitutes any of the forms of financial contribution listed in Article 1.1(a)(1). The two are distinctly separate legal elements which together determine whether a subsidy exists.\textsuperscript{179}

The Appellate Body stated in the case \textit{US – Softwood Lumber IV} that the drafters of the SCMA introduced the notion of “financial contribution” and limited its definition to the

\begin{itemize}
\item[\textsuperscript{176}] Panel Report \textit{US – Export Restraints} at ¶8.73 and Appellate Body Report, \textit{US – Countervailing Duty Investigation on DRAMS} at ¶113.
\item[\textsuperscript{177}] Appellate Body Report, \textit{US – Countervailing Duty Investigation on DRAMS} at ¶108.
\item[\textsuperscript{179}] Appellate Body Report, \textit{Brazil – Aircraft} at ¶157.
\end{itemize}
exhaustive list constituted by subparagraphs (i)-(iv) in order to foreclose the possibility of treating any government action that resulted in a benefit as a subsidy.\textsuperscript{180}

The most important difference between these two legal elements is that the existence of benefit is determined by the effects of a measure, whereas the determination of the existence of a financial contribution is centered on the nature of the government action. As the panel stated in \textit{US – Export Restraints}, to “hold that the concept of financial contribution is about the effects, rather than the nature, of a government action would be effectively to write it out of the Agreement, leaving the concepts of benefit and specificity as the sole determinants of the scope of the Agreement”.\textsuperscript{181}

A lot of the arguments stating that an undervalued currency constitutes a financial contribution seem to do just this. They concentrate on the effects of the undervalued exchange rate, ignoring the nature of the government actions giving rise to the undervaluation.

7.2.3 \textit{Income or Price Support}

According to Article 1.1(a)(2), a subsidy can also be the result of “any form of income or price support in the sense of Article XVI of the GATT 1994”. GATT Article XVI Section A deals with subsidies (including any form of income or price support) which operate directly or indirectly to increase exports of any product from, or to decrease imports of any product into, its territory. Unfortunately neither the GATT nor the SCMA provides any further form of guidance regarding the meaning of this term.

At first glance this provision could seem to cover situations such as currency undervaluation, which clearly operate indirectly to increase exports from and reduce imports into the state manipulating its currency. Support for this interpretation could be found in the comment of the Appellate Body stating that the concept of “income or price support” broadens the scope of measures that can be considered subsidies beyond those that constitute financial contributions under Article 1.1(a)(1).\textsuperscript{182}

However, in the case \textit{China – GOES}, the panel concluded that the term “price support”, read in its context of Article 1.1 of the SCMA, suggests a rather narrow interpretation of


\textsuperscript{182} Appellate Body Report, \textit{US – Softwood Lumber IV} at ¶52.
the term. In interpreting the term, the panel commenced from the dictionary definition given in *Blacks Oxford Dictionary of Economics*, which states that price support includes “government policies to keep the producer prices … above some minimum level”. The panel then referred to the ruling in the case *US – Export Restrictions*, in which the important “gateway” role of the term “financial contribution” in the SCMA and the important distinction between financial contribution and benefit were brought up. The panel in *China – GOES* quoted the ruling of the panel in *US – Export Restrictions*, stressing that the concept of financial contribution is not about the effects, but the nature of the action. Based on this reasoning, the panel stated that the term “price support” also functions as a gateway to the SCMA and found that the term does not include all government intervention that may have an effect on prices. The panel also went on to examine the concept of “market price support” included in the Agreement on Agriculture. Price support in the sense of this agreement requires a direct form of government control over domestic prices and does not cover the movement in prices being a mere side effect of another form of government intervention.

Taking into consideration this ruling and using analogy to apply it to the term “income support” as well as price support, it would be logical to conclude that the concept of “any form of income or price support” in the sense of Article 1.1(a)(2) is not wide enough to cover the effects of a state’s currency undervaluation. If the term is to be interpreted in accordance with the panel’s ruling (and therefore harmoniously with the interpretation of the concept of financial contribution), the determination of whether a government measure constitutes income or price support should be based on the nature, not the effects, of the government action increasing exports and decreasing imports. Government actions bringing about currency undervaluation are not aimed at setting domestic producer prices or income above a minimum level, and therefore they cannot be considered income or price support despite the effects they have on trade flows.

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183 Panel Report, *China – GOES* at ¶7.84.
7.3 Benefit

The second criterion of the definition of a subsidy is that a benefit is conferred to the recipient of the financial contribution (or income or price support). According to the case law interpretation of benefit, emphasis should be put on what has been conferred to the recipient, rather than possible costs to the government.

It has been established that a benefit exists when the financial contribution makes the recipient “better off” than it would have been without the financial contribution. According to the Appellate Body in the case Canada - Aircraft, the appropriate basis for comparison in determining whether or not the financial makes the recipient “better off” is the marketplace. Therefore, a benefit is deemed to exist when the recipient receives the financial contribution on conditions that are more advantageous than those available on the market. This has later been upheld in numerous other cases by both the panel and the Appellate Body.

A clear example of this would be a dual exchange rate regime in which exporters are allowed to exchange their foreign currency, for example with the state’s central bank, at a rate that is more advantageous than the exchange rate applied on the free currency market. In a system of this kind, the benefit would be the difference in the amount of units of domestic currency exporters got in exchange for their foreign currency from the central bank, and the amount of units of domestic currency they would get if they were to exchange their foreign currency on the free currency market. The problem in the case of currency undervaluation is that the government measures that allegedly give rise to the financial contribution have done so by altering the exchange rate available on the market.

In the recent case EC – Aircraft, the Appellate Body stated that in order for the comparison regarding whether the financial contribution has made the recipient “better off” to be meaningful, the benchmark that is used to determine whether the recipient is “better off” must not itself be distorted by the financial contribution. Rather, the benchmark must

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186 SCMA Article 1.1(b).
187 Appellate Body Report, Canada – Aircraft at ¶154.
188 Appellate Body Report, Canada – Aircraft at ¶157.
189 Panel Report, Brazil — Aircraft at ¶7.24; Panel Report, Korea — Commercial Vessels at ¶7.427; Panel Report, EC — Countervailing Measures on DRAM Chips at ¶7.176; Appellate Body Report, Japan — DRAMs (Korea) at ¶225 and Appellate Body Report, EC and certain member States — Large Civil Aircraft at ¶705.
reflect conditions in the market "absent the contribution". Otherwise, it would not be possible to determine whether the financial contribution placed the recipient in an advantageous position, because the benchmark used in the comparison itself reflects the financial contribution.\(^{190}\)

In the case of currency undervaluation, in order to establish whether or not a benefit exists, one would have to determine an undistorted benchmark exchange rate. It would have to be proved that the actual exchange rate is indeed undervalued, and to do this one would have to calculate what the exchange rate would be absent the government interventions taken to manipulate it. This would not be an easy feat. First of all, one would have to determine the level of interventions at which normal government policies become currency manipulation, since all forms of exchange arrangements, except freely floating ones, require some sort of government intervention. Secondly, an economic analysis of the precise amount of undervaluation would have to take into consideration a large number of factors that are constantly changing, making the calculation extremely complicated and variable to say the least. This is well illustrated by the fact that estimates of the undervaluation of the Chinese renminbi vary from 20-40 per cent.\(^{191}\)

There are many different methods that can be used to calculate an equilibrium exchange rate, all of which produce somewhat differing results. It has been argued by some scholars that this would be a positive aspect in a hypothetical WTO dispute: the more methods can be used, the more evidence there is of the misalignment between the exchange rate and its equilibrium value, and it would be up to the panel or Appellate Body to make the final judgment regarding the level of undervaluation.\(^{192}\)

At first thought it seems undeniable that exporters benefit from the undervalued exchange rate, and the only problems would be related to the calculation of the benefit. However, even this has been questioned by academics. Staiger and Sykes state that “no benefit exists if prices have adjusted to eliminate all real effects of the practice.”\(^{193}\) Koops points out that the conferral of benefit is also dependent on firm-specific production structures. If the firm

\(^{190}\) Appellate Body Report, \textit{EC – Aircraft} at ¶900.


needs imports (e.g. raw materials or fuel) in order to produce the products that are exported, no benefit exists. The reason for this is that the two effects of currency undervaluation, cheap exports and expensive imports, ultimately cancel each other out.

7.4 Specificity

In order to fall under the provisions of the SCMA, a subsidy must also fulfill the third criterion of specificity. According to Article 2, a subsidy shall be deemed to be specific if it is limited to an enterprise or industry or group of enterprises or industries, or to a group of enterprises located within a certain geographical region. According to Article 2.3, a subsidy is also automatically deemed specific if it falls under Article 3 as a prohibited subsidy. Since an undervalued currency is applied to all enterprises and industries within the territory of the state, the first form of specificity clearly does not come into question. Therefore, in order to fulfill the specificity criterion, an undervalued currency would have to constitute a prohibited export subsidy in the sense of Article 3.1(a).

8 Prohibited Export Subsidies

8.1 Illustrative List of Export Subsidies

Article 3.1(a) prohibits subsidies contingent, in law or in fact, upon export performance, including those illustrated in Annex I. A subsidy in the form of any of the items listed in the illustrative list of Annex I is automatically prohibited, and there is no need to demonstrate that it fulfills the conditionality requirement of 3.1(a). The illustrative list includes eleven different forms of export subsidies, but does not mention undervalued exchange rates. Several authors have asserted that the fact that such a well-known form of export promotion has been left out of the illustrative list must be taken to mean that it was not intended to be included in the scope of the WTO provisions on subsidies.


Considering that the list is *illustrative* and therefore not exhaustive, this seems like a rather radical interpretation. As stated by the Appellate Body in *Canada – Autos*, omissions have different meanings in different contexts, and the fact that something is omitted does not necessarily mean that it was not intended to be included in the scope of the provision.\(^{197}\)

Taking into consideration the context of the illustrative list as *examples* of export subsidies, it is rather safe to say that the omission of exchange rate undervaluation from the list does not directly exclude the possibility that an undervalued currency could constitute an export subsidy prohibited under Article 3.1(a). As Zimmermann points out, the drafters of the SCMA could have had many reasons not to include an explicit mention of exchange rate policies, seeing as they are politically a very sensitive issue.\(^{198}\) Since there is no negotiating history that would shed light on what the reasons for leaving out exchange rates were (or whether they were discussed at all), no definite conclusions can be made on the basis of Annex I.

This being said, in *EC – Aircraft*, the Appellate Body found that “a common feature of the examples provided in most of the items of the illustrative list in Annex I is that the subsidy gives certain advantages to exported products and favours exported products over products destined for domestic consumption”.\(^{199}\) It went on to state that export-contingent subsidies favour a recipient’s export sales over its domestic sales. These clarifications support the interpretation that an undervalued exchange rate that results in benefits for exporters fits under the rationale of Art. 3.1(a).

There are two items in particular which are similar in their effects to an undervalued currency, items (b) and (j). Item (b) mentions currency retention schemes or *any similar practices which involve a bonus on exports*. According to Siegel, a currency retention scheme “usually involves allowing certain exporters to retain a portion of their foreign exchange earnings notwithstanding a general rule for residents to surrender receipts of foreign exchange … in exchange for local currency”.\(^{200}\) Although this is clearly not the case in the maintaining of an undervalued exchange rate policy, the addition of “any similar practices which involve a bonus on exports” does widen the item indefinitely. An

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\(^{197}\) Appellate Body Report, *Canada – Autos* at ¶138.


\(^{199}\) Appellate Body Report, *EC – Aircraft* at ¶1053.

undervalued exchange rate certainly involves a bonus on exports, but whether it could be considered a practice similar to a currency retention scheme is doubtful.

Item (j) prohibits the granting of export credit guarantee or insurance programmes that ensure exports against exchange rate risks at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes. As argued above, an undervalued exchange rate protects exporters against fluctuations in the value of their domestic currency and therefore saves them from the need to hedge against foreign exchange losses. Since this is a result of the exchange rate policy of the state, it is provided to exporters free of charge and therefore, it could be said, at a premium rate. The long-term operating costs and losses of maintaining an undervalued exchange rate, however, are extremely difficult (if not impossible) to calculate. Moreover, it would be quite a stretch to deem an exchange rate policy as an “export credit guarantee or insurance programme”. It is unlikely that a panel would interpret this item to include government actions which are not the services meant, but rather have the effect of rendering such services redundant.

Because currency undervaluation does not fall directly under any of the items listed in Annex I, it is necessary to examine whether it fulfills the criteria of an export subsidy set in Article 3.1(a) of the SCMA.

8.2 De Facto and De Jure Export Contingency

Article 3.1(a) prohibits subsidies that are contingent, either in fact or in law, upon export performance, whether solely or as one of several other conditions. As stated by the Appellate Body in Canada – Aircraft, the key word in this provision is ”contingent”, which means “conditional” or “dependent for its existence on something else”.201 The criterion of contingency is the same for both de jure and de facto export contingency, the only difference being in the sort of evidence that can be used to prove contingency upon export. In the case of de jure contingency, proof can be found in the actual wording of the relevant legislation, regulation or other legal instrument, whereas in the case of de facto contingency no such written proof exists. For this reason, contingency in fact upon export performance “must be inferred from the total configuration of the facts constituting and

201 Appellate Body Report, Canada - Aircraft at ¶166.
surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case”. 202

In the case of currency undervaluation, de jure export contingency can essentially be ruled out. 203 A hypothetical panel’s evaluation of whether an undervalued currency constitutes a prohibited export subsidy would most likely concentrate on the determination of whether the standard of de facto contingency is met.

8.3 Evaluation of De Facto Contingency

Footnote 4 to Article 3.1(a) provides that the standard of de facto contingency is met when “the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings”. The second sentence of the footnote continues by specifying that “the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.”

As the Appellate Body clarified in Canada – Aircraft, the standard set in footnote 4 requires the existence of three distinct elements: 1) the granting of a subsidy 2) is tied to 3) actual or anticipated exportation or export earnings 204. The first element requires simply that the focus of the inquiry be on the granting authority and not the recipient. As for the second element, the words “tied to” emphasize the relationship of conditionality between the granting of the subsidy and export. The granting authority’s anticipation that exports would result from the granting of the subsidy is not sufficient to fulfill this requirement; the granting of the subsidy must be contingent upon either actual or anticipated exports. 205 According to the Appellate Body, the second sentence of the footnote serves to demonstrate this element. The third element, actual or anticipated exportation, must be kept separate from the second element of conditionality. “Anticipated exportation” does not signify that the element is fulfilled by examining the

202 Appellate Body Report, Canada – Aircraft at ¶167.
204 Appellate Body Report, Canada – Aircraft at ¶169.
205 Appellate Body Report, Canada – Aircraft at ¶170-171.
granting authority’s expectations of exports, but rather based on an examination of objective evidence.\textsuperscript{206}

In \textit{EC – Aircraft}, the Appellate Body established a test for the determination of whether a subsidy is contingent in fact upon export performance. According to the Appellate Body, assessment could be based on the comparison of the ratio between exports and domestic sales when the subsidy is granted and the same ratio in the absence of the subsidy in question. If the comparison shows that, all other things equal, the granting of the subsidy incentivizes exports in such a manner that a profit maximizing firm prefers to export instead of sell its products on the domestic market, this would be considered evidence that the subsidy is tied to anticipated exportation.\textsuperscript{207}

In order to benefit from an undervalued exchange rate a producer must export, because by exporting it receives foreign currency which it can then convert into domestic currency at the preferential exchange rate. Moreover, undervalued exchange rates are more often than not specifically used as part of a state’s export promotion strategy, due to the fact that an undervalued currency increases exports. Based on these arguments, an undervalued currency would seem to fulfill the elements of \textit{de facto} export contingency. However, it has been pointed out that it is possible to benefit from an undervalued exchange rate also without exporting. For example foreign investments into the country and the country’s own tourism sector also benefit from the exchange rate.\textsuperscript{208} For this reason it is rather unlikely that a panel would find that an undervalued currency constitutes a subsidy contingent in fact upon export performance.

\textsuperscript{206} Appellate Body Report, \textit{Canada - Aircraft} at ¶172-173.

\textsuperscript{207} Appellate Body Report, \textit{EC – Aircraft} at ¶1047.

9 Proposals for Action

Based on the analysis presented above, challenging currency undervaluation under the provisions of the SCMA would be very unlikely to succeed for a multitude of reasons. Firstly, currency undervaluation seemingly fails to fulfill the three cumulative criteria of a subsidy set in Article 1 of the SCMA. The most problematic of the three is the criterion of a financial contribution or income or price support, which strictly speaking does not exist in the case of currency undervaluation, but also the element of benefit is questionable. Even if the existence of a benefit could be proven it would be close to impossible to calculate and therefore the amount of subsidy granted could never be more than an estimate at best. As for the requirement of specificity, it could only be fulfilled if it were proven that the subsidy granted was contingent upon export and since an undervalued currency benefits not only exporters but also for example foreign investors and the tourism sector, this element is not fulfilled.

Moreover, widening the interpretation of the provisions of the SCMA to cover situations of currency undervaluation could set an undesired precedent for future cases related to currency issues and upset the balance between the WTO and IMF. This argument holds also in relation to other WTO provisions that could possibly be interpreted in such a manner as to encompass currency undervaluation. The obvious problem with widening the scope of provisions in this manner is that in accordance with Article 3.2 of the Dispute Settlement Understanding, the panel or Appellate Body cannot add to or diminish the rights and obligations of members. In the case of currency undervaluation, widening the interpretation of WTO provisions would not only add to the obligations of members, but also move into the territory of monetary sovereignty. As Jung points out, “a waiver to a state’s sovereign right should not be made implicitly without convincing evidence that the state’s accepted international obligation actually includes such waiver”.

Possible solutions to the problem are many, suggestions ranging from leaving the matter completely to the IMF or adapting and improving cooperation between the WTO and

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IMF\textsuperscript{211} to negotiating an entirely new agreement regulating currency manipulation\textsuperscript{212}. Some have even gone so far as to propose the establishment of a completely new organization, the World Financial Authority.\textsuperscript{213}

As for the first proposal, it seems that after decades of doing relatively nothing about the problem of the trade effects of currency manipulation, the IMF has woken up to the problem and commenced action in order to find a solution. In 2007, thirty years after the first Bilateral Surveillance Decision, the Fund’s Executive Board adopted a new decision on bilateral surveillance over members’ policies. The IMF’s Public Information Notice on the decision stated that the new decision “brings greater clarity and specificity to what exchange rate policies countries should avoid and when these policies may be of concern to the international community”. According to the Public Information Notice, the new decision “clarifies the concept of exchange rate manipulation in order to gain an unfair competitive advantage over other members, which is prohibited under Article IV” and also “adds a principle recommending that members avoid exchange rate policies that result in external instability, regardless of their purpose, thereby capturing exchange rate policies that have proven to be a major source of instability over the past decades”.\textsuperscript{214} The novelties introduced by the 2007 Bilateral Surveillance Decision are discussed in more detail above in section 3.2.

Although the new decision can be considered as a move in the right direction because it has turned the focus to exchange rates and may well serve to strengthen surveillance, it does not resolve the underlying problem. The guidelines provided in the decision bring nothing new to the past practice of surveillance, and the IMF Articles of Agreement remain


\textsuperscript{214} IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members’ Policies, Public Information Notice (PIN) No. 07/69, June 21, 2007.
unchanged. The inherent problems of Article IV(1)(iii), which have been discussed above, remain unaffected. A more viable option might therefore be the amendment of Article IV(1)(iii). However, it would take three fifths of the IMF members having 85 per cent of the total voting power in order to effectively amend the Articles of Agreement. Considering how reluctant states are to give up aspects of their monetary sovereignty, this seems highly unlikely in the present political and economic climate. The fact that during the US-China dispute, states have systematically opted to strive for a diplomatic solution, instead of calling actively for an amendment of the IMF’s Articles of Agreement, can be seen as an indication of this. Moreover, Zimmermann argues that even modifying Article IV(1)(iii) so that it no longer included a subjective element would not bring a solution to the problem: “[E]ven with that sort of modified rule, the IMF would likely not proceed to a formal finding of breach immediately after establishing that one of its members is manipulating its exchange rate in a way that produces one or several prohibited results”.

Mattoo and Subramanian propose another solution: amending WTO rules in order to include exchange rate regulation under the scope of the WTO dispute settlement system. The two conditions to be met would be 1) a clear finding of currency undervaluation and 2) proof that it is attributable to governmental action. The system Mattoo and Subramanian describe is very similar to the existing one regarding restrictions taken for balance of payments reasons. In the same manner, the IMF’s input would be limited to a technical determination at the request of the panel, based on which the panel would then make its decision on whether a breach of the WTO provisions exists. This system would make it possible to “harness the comparative advantage of the two institutions, with the WTO

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216 IMF Articles of Agreement, Article XXVIII: Amendments.


providing the valuable enforcement mechanism and the IMF providing the essential technical expertise to this enforcement process.” The obvious question that arises is why states be willing to make this addition to WTO provisions if they do not wish to have the issue addressed effectively under the IMF? For example Zimmermann has pointed out that it seems “more than just unlikely” that such a rule could be negotiated under the WTO given the fact that China already objected to the IMF’s 2007 Bilateral Surveillance Decision, which was able to be passed only because China did not have the power to veto. The answer provided by Mattoo and Subramanian is that the rule would be added as part of a larger package of negotiations on various issues and the members against such an addition would have the bargaining power to demand concessions in return.

Whereas in the United States internal political forces have initiated several administrative and legislative proposals, which so far have led to no action being taken, Brazil has been systematically calling for WTO members to address currency undervaluation under the WTO. The interesting aspect in Brazil’s case is that it sees the United States, so clearly the accuser in the China case, as the perpetrator. Brazil argues that the policy of quantitative easing implemented by the United States depreciates the value of the U.S. dollar, thus causing the value of the Brazilian currency to rise and making it difficult for Brazil to export. Brazil’s proposal is a two-pillared program that focuses first on understanding the connection between international trade and exchange rates and secondly on international institutions and the possibilities for states to seek redress under their auspices. What Brazil proposes is the creation of a specific trade remedy that could be used to neutralize the harmful effects of currency undervaluation. Although Brazil has been successful with


regard to the first pillar of its program, the suggestion of an exchange-rate trade remedy has been met by the international community with aversion.\textsuperscript{226}

The only aspect academics and politicians alike seem to agree on is that the current situation is unsustainable, and something needs to be done or states will continue to exploit the legal “loophole”, causing serious trade imbalances and undermining the effects of the WTO agreements.

10 Conclusion

The currency dispute between the USA and China has shown that, even in accentuated situations where big numbers are at stake, states seem to be unwilling to pursue anything but diplomatic channels in the fight against currency manipulation. This could be for several reasons; out of respect for the monetary sovereignty of states and the reluctance to strain diplomatic and commercial relations, or perhaps even out of fear of spending millions on a WTO dispute, the outcome of which is uncertain at best.

The problems in adjudicating currency manipulation essentially arise from historical developments and the failure to adapt the instruments of international law to a new economic reality. This, together with the fear of overlapping jurisdictions between international institutions has led to a loophole in international economic law. Initially the division of authority between the WTO and the IMF was clear: exchange rate issues under the par value system were a matter to be dealt with exclusively within the IMF. After the breakdown of the par value system, misuse of monetary policies became easier and more frequent, but nothing was done to reinforce the authority of the IMF. This has led to a situation where the IMF has the jurisdiction to deal with exchange rate issues, but lacks an effective enforcement mechanism to ensure that its rulings are followed. The WTO on the other hand has at its disposal an extremely effective dispute resolution mechanism but lacks jurisdiction regarding currency issues.

At present, neither the IMF nor the WTO rules seem to be able to provide an answer to the problem of currency undervaluation. Although the IMF Articles of Agreement contain a hard obligation to avoid currency manipulation, the provision is worded in a manner that makes it impossible to apply in practice. The rules of the WTO agreements, on the other hand, were originally not drafted to deal with currency matters, because they are not included in the organization’s jurisdiction. Although the interpretation of more than just one WTO provision could perhaps be stretched to cover currency undervaluation, it would be unwise to leave such a drastic expansion of WTO jurisdiction to the decision of the dispute settlement body. Such a decision would also constitute a dangerous precedent, opening the floodgates for all kinds of disputes related to currency matters. Without a mandate to address such matters, and lacking provisions specifically drafted to do so, the issue would be left almost entirely to the discretion of the panel and Appellate Body, which
does not seem a commendable solution and would certainly not be to the liking of members of most members of the WTO.

The issue of currency undervaluation requires a sustainable solution that would resolve the matter conclusively and prevent states from exploiting the international monetary system at the expense of international trade. Seeing as conflicting interests of various states and the states’ fear of having to give up further aspects of their monetary sovereignty make it impossible at present to amend either the rules of the IMF or the WTO or to draft a whole new agreement addressing the matter, perhaps the most viable option would be to turn to instruments of soft law, at least for the time being.