Us-China Trade Imbalance: The Economic, Political, and Legal Implications of Chinese Currency Manipulation

Joshua Brown
US–CHINA TRADE IMBALANCE: THE ECONOMIC, POLITICAL, AND LEGAL IMPLICATIONS OF CHINESE CURRENCY MANIPULATION

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Abstract

This article presumes that Chinese currency manipulation has a negative impact on world markets, in particular the United States, and explores potential remedies available to U.S. policy makers. First, the history of China’s currency manipulation leading up to the present day will be examined. Then, four potential remedies to Chinese currency manipulation will be discussed in turn, including: (1) the General Agreement on Tariffs and Trade in effect under the WTO framework; (2) the International Monetary Fund’s Articles of Agreement; (3) the Omnibus Trade and Competitiveness Act of 1988; and (4) the Currency Exchange Rate Oversight Reform Act of 2011.

While the Congressional Acts discussed offer plausible mechanisms by which the United States could confront China’s undervaluation of its currency, the effectiveness of such acts is inherently limited by their unilateral nature. On the other hand, the added leverage provided through the multilateral approach (i.e., the International Monetary Fund), in which the United States acts in conjunction with other countries that are also negatively affected by China’s currency undervaluation, seems the more promising solution. This solution could be achieved through the “Geneva Consensus,” by which the World Trade Organization, with the International Monetary Fund’s guidance, would exert pressure on China to bear the burden of adjustment by recycling its surplus to deficit countries, including the United States.

I. INTRODUCTION

Amid the backdrop of deepening economic contraction, many figures within the United States have called for increased scrutiny of China’s currency regime. As of this writing, the United States, having endured a

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deep recession just two years prior, appears headed into yet another recession. The number of unemployed persons remained at 14.0 million and the unemployment rate held at 9.1%. According to CBS News, “there are nearly 25 million Americans who are either out of work or working part-time,” wages remain stagnate, the housing market is still in the tank, and the credit binge has resulted in a bad hangover phase for the economy. The employment situation is so dire that a small protest addressing this issue recently started in a small park in New York City and transformed into an international social movement, spreading across the country and around the world.

China’s practice of currency manipulation may be one of the reasons that the U.S. economy has failed thus far to recover. Many assert that China manipulates its currency in order to promote growth of its exports while protecting domestic industries from international competition. Such undervaluation keeps the prices of Chinese goods low and the prices of foreign goods out of reach of the Chinese consumer. It is thus argued that this undervaluation grants Chinese exporters an unfair and artificial trading advantage, producing negative effects on both the U.S. economy and the global trading system. Consequently, an undervalued Chinese currency, among other things, led to a U.S. trade deficit with China of $226.8 billion in 2009, $273 billion in 2010, and $295.4 billion in 2011. Because the trade deficit has continued to grow, China’s currency manipulation must be addressed with urgency; doing so could potentially strengthen the U.S. economy by reducing its unhealthy dependence on Chinese imports.


4 Jill Schlesinger, Are We Headed for Another Recession?, CBS MONEY WATCH (Aug. 19, 2011, 10:46 AM), http://www.cbsnews.com/8301-505123_162-38044892/are-we-headed-for-another-recession/ (reporting on the current recession-like U.S. economy, giving tips to individuals on how to deal with the current economic malaise, and noting that, as of the writing of the article, corporations had exited the “hangover phase,” and continued to rack up profits, while 25 million Americans are either out of work or working part-time).

5 See Henry Blodget, CHARTS: Here’s What the Wall Street Protestors Are So Angry About…, BUSINESS INSIDER (Oct. 11, 2011, 1:03 PM), http://www.businessinsider.com/what-wall-street-protestors-are-so-angry-about-2011-10?op=1 (stating that the Occupy Wall Street protestors have legitimate gripes, given the current unemployment and wealth disparity situations in the U.S. and warning of an increasing de-stabilization within the U.S.).


7 See id.

8 See id.

However, the exact effect of China’s currency regime on the U.S. economy, in particular its effect on U.S. jobs, is unclear. Some prominent figures reject the notion that a rise in the value of China’s currency would improve the U.S. job market. Still, researchers have shown that between 2001 and 2010, China’s currency manipulation was a major cause of the rapidly growing trade deficit with China, which in turn resulted in the elimination or displacement of 2.8 million jobs, 1.9 million of which were in manufacturing. These losses account for “nearly half of all U.S. manufacturing jobs lost or displaced between China’s entry (in 2001) into the World Trade Organization (WTO) and 2010.”

II. CHINESE CURRENCY MANIPULATION

A. China’s Currency Exchange Regime

China’s official currency is the renminbi (RMB), meaning “the people’s currency.” RMB is not freely traded in the international currency market and is issued and controlled solely by the central bank of China, known as the People’s Bank of China (PBOC). Experts believe that between 1994 and 2005, “China maintained a fixed exchange rate, or peg, of 8.28” RMB per U.S. dollar (USD). For many years, China did not need to take any action to keep the supply of RMB in line with demand, but as “demand for Chinese goods and services increased, more RMB were required to purchase those goods and services, resulting in an upward pressure on the value of the RMB.” To counter an appreciating RMB, the Chinese government, through the PBOC, began to increase “the supply of RMB and decrease the supply of another nation’s currency by purchasing that nation’s currency on the open currency market,” to maintain the 8.28 RMB per USD value of its

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10 See Department of State Washington File: Greenspan Sees China’s Currency Peg Unrelated to U.S. Job Losses, AM. INST. OF TAIWAN (Dec. 11, 2003), http://wfile.ait.org.tw/wf-archive/2003/031211/epf409.htm (reporting on U.S. Federal Reserve Chairman Alan Greenspan’s conclusion that an action by China to remove its fixed exchange rate policy and permit the RMB to appreciate, “would be unlikely to have much, if any, effect on aggregate employment in the United States”).
12 Id.
16 Sharobeem, supra note 15, at 698.
currency. As a result, in “2000 China had currency reserves of $165 billion,” equivalent to 10% of their gross domestic product (GDP). By the end of 2009, China had currency reserves of $2.4 trillion, accounting for more than 50% of their annual GDP.” More recently, China’s foreign exchange reserve purchases have reached unprecedented levels, with purchases of $728 billion between June 30, 2010 and June 30, 2011. As of June 30, 2011, China held a total of $3.2 trillion in foreign exchange reserves, about 70% of which were held in U.S. denominated assets. Many of these purchases were of U.S. Treasury bonds and other foreign securities. According to some estimates, the Chinese government purchases about $1 billion daily in currency exchange markets to fight appreciation of the RMB, thereby maintaining “an artificially strong competitive advantage.”

The Chinese government has also employed strict capital controls to regulate the supply of RMB to combat appreciation. For example, in 1996, China imposed stringent procedures for businesses and individuals to convert RMB to foreign currency, through its Rules on Foreign Exchange Control (Rules). The Rules implemented a prohibition on any pricing and settlement of accounts in foreign currency on “all individuals and businesses within China, including foreign exchange revenues and expenditures of foreign operations in China.” The Rules further required that all “foreign exchange earnings of China-based residents back into China and deposited in authorized foreign exchange banks.” Furthermore, the government “required firms in China to exchange most of their hard currency earnings to the central government in exchange for RMB.” While China did eventually allow for the free convertibility of trade transactions, capital transactions remained under strict controls to avoid “unpredictable flows of capital into or out of the country.”

17 Id.
19 Id.
20 Scott, supra note 11, at 4-5.
23 Mihalakas, supra note 18.
24 See Sharobeem, supra note 15, at 698.
25 See Lou, supra note 14, at 458.
26 Id.
27 Id.
28 Sharobeem, supra note 15, at 698.
29 Id.; see also Timothy A. Canova, Banking and Financial Reform at the Crossroads of the Neoliberal Contagion, 14 AM. U. INT’L L. REV. 1571, 1586 (1999) [hereinafter The Neoliberal...
Due to increasing trade with the United States, a ballooning trade surplus with the United States, and pressure from its trading partners and the International Monetary Fund (IMF), China announced in 2005 that it would implement a new hybrid exchange rate system. Under this system, regulation would allow the value of the RMB to appreciate from 8.27 to 8.11 RMB/USD, a 2.1% increase. The new system would link the RMB to a “basket” of currencies, widely thought to be “the euro, yen, the U.S. dollar, as well as other Asian currencies.” Lastly, the RMB would be allowed to fluctuate by 0.3% each day above or below a central parity, which was determined by “the closing price of ... the U.S. dollar traded against the RMB . . . after the closing . . . of the market each working day.” Most likely by intention, Chinese officials did not explain how the central parity was set. In effect, the closing price is fixed by the PBOC through its currency manipulation. The central parity merely refers back to its own price, allowing a 0.3% fluctuation from the previous day’s price. Even with its inherent advantages, this hybrid exchange system lasted only six days, and was replaced by a “managed float” system, whereby the PBOC would consider the daily changes of the RMB relative to the basket of currencies and enjoy full discretion in determining what the exchange rate would be.

Under these new systems, between 2005 and 2008, China allowed the value of the RMB to appreciate between 20% to 25% against the USD. While some credit this gain to “pegging” the RMB’s value to a basket of currencies rather than the USD alone, others attribute this change to the broad-based decline in the value of the USD caused by a sharp downturn in the U.S. economy. However, at the beginning of the 2008 economic crisis, China switched back to pegging the value of the RMB to the value of the USD. Still, despite what currency or currencies the RMB is pegged to, the RMB’s value might simply be attributed to Chinese currency manipulation. Put another way, even if the USD is not depreciating against the broad basket of currencies, the USD could

Contagion] (“[A] country that does not protect itself against short-term hot money inflows is susceptible to market hysteria and thus an economic outflow.”).

See Sharobeem, supra note 15, at 700.

31 Id.

32 Id. at 700-701.

33 Id. at 701 (discussing the various forms or exchange rate systems, specifically, the differences between a fixed exchange rate, a floating exchange rate, a “crawling peg,” and a “managed float”).

34 See id.

35 See Pettis, supra note 6, at 282.

36 See Sharobeem, supra note 15, at 701 (attributing the 20% to 25% appreciation in the value of China’s RMB directly to China’s shift in policy from a peg to the USD to a policy in which it loosely pegged the value of the RMB to a “basket” of major currencies that included the USD, the euro, and the Japanese yen; but cf. id. at 702 (attributing the RMB’s notable gains against the USD largely due to a broad-based decline in the value of the USD precipitated by the recent ongoing problems in the U.S. economy).

37 See Pettis, supra note 6, at 282.
naturally depreciate against the RMB due to the huge payments imbalance between China and the United States. If this is the case, then the depreciation of the USD against the RMB occurs as a result of China’s currency regime.

Once again, amid growing international pressure over the undervaluation of its currency, China announced in June 2010 that it was removing the RMB’s peg to the USD in favor of the previous “managed float” exchange system, however, as of September 10, 2010, the value of the RMB had risen by less than 1%.38 Many U.S. experts believe that the market currently undervalues the RMB by 15% to 40%.39

B. Legal/Political Solutions to Chinese Currency Manipulation

1. WTO/GATT

a. GATT Article XV

As China and the United States are both members of the World Trade Organization (WTO), the United States could pursue its case against China regarding currency manipulation through application of the WTO’s governing rules, the General Agreement on Tariffs and Trade (GATT).

Specifically, many scholars have focused on the possibility of using Article XV of the GATT.40 Article XV, which deals with exchange rates between two or more countries, states in relevant part: "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."41

39 See, e.g., U.S. Gov’t Accountability Office, GAO-05-351, International Trade: Treasury Assessments Have Not Found Currency Manipulation, But Concerns About Exchange Rates Continue 22 (2005) [hereinafter GAO Report] (explaining that in the studies the Accountability Office had reviewed, all of which had utilized the External Balance approach, which is based on calculating an exchange rate that would result in a country achieving a sustainable balance in its external accounts, such as its current account balance or its trade balance, this approach generally produced estimates of currency undervaluation for China from 4% to 25%, with one estimate of 40%); see also Sharobeem, supra note 15, at 704 (noting that even among the critics of Chinese currency policy, “there seems to be no consensus as to how much the renminbi is undervalued,” with one expert estimating the RMB to be undervalued by 40%, the Institute for International Economics believing the RMB to be undervalued by approximately 15% to 25%, Goldman Sachs Research Group placing the undervaluation at about 9.5% to 15%, and yet another expert estimating that the RMB was undervalued by as much as 35% in 2000); see also Mihalakas, supra note 18 (noting that many U.S. experts believe that the RMB is 25% to 40% undervalued).
40 See Sharobeem, supra note 15, at 725; see also Bryan Mercario & Celine Sze Ning Leung, Is China a “Currency Manipulator”?: The Legitimacy of China’s Exchange Regime Under the Current International Legal Framework, 43 INT’L LAW. 1257, 1285 (2009); see also Pettis, supra note 6, at 287; see also Lou, supra note 14, at 475.
Furthermore, Article XV, section 2 states:

In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments . . . \(^{42}\)

Based on the text, it is clear that under Article XV of the GATT, the IMF would act in a consulting capacity to both China and the United States (the “CONTRACTING PARTIES”) in a dispute brought by the United States against China. Under the Article, the United States would have to demonstrate to a dispute resolution body of the WTO that: (1) China’s currency manipulation is an “exchange action” under Article XV of the GATT; and (2) this manipulation “frustrates” the “intention” of the provisions of the GATT.\(^{43}\) Moreover, should the United States decide to file a complaint against China to the WTO under Article XV, the United States would have to accept as final the IMF’s decision on China’s currency manipulation.\(^{44}\) This risk of the United States having to abide by a binding decision against it might be countered by the U.S.’s effective veto power in the IMF, in that it has the ability to often set IMF policy.\(^{45}\) Even so, Article XV does not define the terms “exchange action” or “frustrate,” nor does it give clear guidance as to the “intention” of the GATT.\(^{46}\) Furthermore, a WTO dispute resolution panel has never dealt with the interpretation of Article XV, Section 4, indicating that there is a lack of precedent.\(^{47}\)

Still, academics have constructed possible interpretations of “exchange action,” “frustrates,” and “intention” within the meaning of the provisions of the GATT, and under these interpretations, the United States might have a veritable claim against China’s currency exchange regime under Article XV of the GATT.\(^{48}\) For example, one scholar

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\(^{42}\) Id. at (2).

\(^{43}\) See Pettis, supra note 6, at 288.

\(^{44}\) See Sharobeem, supra note 15, at 725.

\(^{45}\) See IMF Members’ Quotas and Voting Power, and IMF Board of Governors, INT’L MONETARY FUND, http://www.imf.org/external/np/sec/memdir/members.aspx (last updated Oct. 22, 2012) (showing IMF members’ quotas and voting power, illustrating that, with 17.70% of the voting power, the United States is the only member that can block the supermajority of 85% required for major decisions).

\(^{46}\) See Pettis, supra note 6, at 288.

\(^{47}\) See id.

\(^{48}\) See id. (reasoning that the United States should argue that the term “exchange action,” in accordance with the ordinary meaning of the root words, means in context, “the effect produced by
formulated a complaint by the United States against Chinese currency manipulation under Article XV by interpreting the meaning “exchange,” “action,” and “frustrate,” through the method prescribed by the customary rules of interpretation set out in the Vienna Convention.\(^{49}\) By forming the meanings of such words based upon the ordinary meaning of the terms used, their context, and the object of purpose of Article XV, the scholar used a combination of definitions from Webster’s New World College Dictionary and an Ad Note of the GATT to construct an argument whereby the United States could complain that China’s currency regime is an “exchange action” that “frustrates” the “intention” of the provisions of the GATT.\(^{30}\)

Noting that the Ad Note is meant to further clarify the term “frustrate,” the scholar remarks that the Ad Note seems to suggest that not all violations of an Article of the GATT would frustrate the intent of the Articles of the GATT within the meaning of Section 4 of Article XV.\(^{51}\) Even though some commentators have suggested that this Ad Note may indicate that a violation under Article XV would further require a violation of a separate GATT provision, the scholar used Article II of the GATT and reasoned that the United States would need to demonstrate a breach by showing that “China’s intentional undervaluation of the RMB makes U.S. products 25% to 40% more expensive than they would otherwise be in the Chinese market and that the undervaluation has nullified the reduction of tariffs on U.S. goods that China had agreed to in its negotiated tariff schedule.”\(^{52}\)

transferring a sum of money of one country for the equivalent in the money of another country” and/or “an action that affects the difference in value between currencies”); see also Mercurio & Leung, supra note 40, at 1286 (highlighting the fact that trade action and exchange action are distinct from each other, stating that “exchange action” relates to the currency and capital, and concerns matters such as currency convertibility or capital movement, and concluding that it is more appropriate to categorize China’s exchange regime as an exchange action because the regime involves a currency peg, thereby requiring policies that manage capital movement and regulate currency convertibility).

\(^{49}\) See Pettis, supra note 6, at 288 (explaining that it is well settled in WTO case law to apply Articles 31 and 32 of the Vienna Convention on the Law of Treatises to interpret relevant GATT Article XV terms).

\(^{50}\) See id. at 287-291.

\(^{51}\) See GATT, supra note 41, at Ad art. XV para. 4 (“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 not appreciable departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import license the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.”).

\(^{52}\) See Pettis, supra note 6, at 290-291 (reasoning that the United States must characterize the intent of Article II of the GATT as either preventing duties from exceeding the concessions agreed to by the member state, or the broader notion that it is providing member states greater access to other member states’ markets); see also GATT, supra note 41, at art. II(1) (“Each contracting party shall
Whatever the interpretation of Article XV of the GATT, there appears to be a consensus among academics that a U.S. complaint against Chinese currency manipulation would be unsuccessful. On the other hand, the U.S. Department of the Treasury (U.S. Treasury) could simply determine that China is guilty of currency manipulation, rendering the U.S. complaint irrelevant. In light of the unclear wording of Article XV, China’s maintenance of the same exchange rate for over a decade, and China’s defenses that it did not “intend” to frustrate (a relatively weak legal defense) the provisions of the GATT, academics agree that such a U.S. challenge to China’s currency regime would be very difficult to establish and would most likely fail. Perhaps underpinning some of these critics’ opinions is the fear that a U.S. challenge may be seen as protectionist and would start a trade war with China. Furthermore, as noted above, there is the risk that an IMF finding that China did not violate Article XV of the GATT would be a final, binding determination by which the United States must abide. However, the risk of a binding determination against the United States could be disingenuous if the U.S. Treasury asserted significant influence over IMF governance, but to do so the U.S. Treasury would need the European Union on board.

b. Is Chinese Currency Manipulation a Subsidy Under the WTO’s Agreement on Subsidies and Countervailing Measures?

Many experts believe that China’s currency regime involving the intentional undervaluing of its currency in order to make Chinese products more competitive than they would otherwise be is, in effect, a subsidy. However, there is not a consensus as to whether China’s...
currency manipulation qualifies as a “subsidy” under the WTO’s narrower legal definition. The WTO’s Agreement on Subsidies and Countervailing Measures (SCM Agreement) directly addresses the meaning of “subsidy.” Article 1.1 of the Agreement states that:

For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a) (1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where:

   (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
   (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
   (iii) a government provides goods or services other than general infrastructure, or purchases goods;
   (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the types of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

(a) (2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and

(b) a benefit is thereby conferred.

In the Brazil – Aircraft case, the WTO Appellate Body (hereinafter “Appellate Body”) stated that “it considers a ‘financial contribution’ and a ‘benefit’ as two separate legal elements which together determine whether a subsidy exists.” Thus, in order to establish that China’s currency regime constitutes a “subsidy” under the SCM Agreement, the United States must establish that China’s currency manipulation “includes both a financial contribution and a benefit.”

In the US – Softwood Lumber III case, the Dispute Resolution Panel clarified the meaning of “financial contribution” under Article 1.1(a)(1)

57 See id.
59 Pettis, supra note 6, at 292.
60 Id.
of the SCM Agreement, declaring that “a financial contribution can exist not only when there is an act or an omission involving the transfer of money, but also in case goods or certain services are provided by the government.” 61 Under such an interpretation, the United States could argue that the Chinese government’s conversion of foreign currency at a fixed rate qualifies as a service or as a transfer of money after the fact. 62 Furthermore, the United States could contend that Chinese exporters are receiving a free service, since after selling their products abroad they exchange USDs for RMB through the Chinese government without a fee. 63 Alternatively, the United States should argue that the Chinese government is directly transferring funds to the exporter after its products are sold, arguably giving the exporter 25% to 40% more RMB than the exchanged USDs are worth. 64

In the Canada – Aircraft case, the Appellate Body addressed the term “benefit” under Article 1.1(b), stating that “a financial contribution will only confer a ‘benefit’, i.e., an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.” 65 Under this definition, it should be relatively easy for the United States to argue that the Chinese government placed its exporters at an advantage by giving them something of value (cash) and that the exporters are better off than they otherwise would be if they had to exchange their USDs for RMB in an open foreign exchange market. 66

Having established that China is giving a subsidy to its exporters under the meaning of Article 1.1 of the SCM Agreement, the United States can next show that China’s distribution of subsidies falls under the types of subsidies that are per se prohibited under the SCM Agreement. 67 Article 3 identifies those subsidies that are per se prohibited under the SCM Agreement, stating that:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article I, shall be prohibited:

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61 Id. at 293; see also Panel Report, United States – Preliminary Determinations with Respect to Certain Softwood Lumber From Canada, WT/DS236/R (Sep. 27, 2002), P 7.24.
62 See Pettis, supra note 6, at 293.
63 See id. at 292 (reasoning that if the Chinese exporter were able to exchange the resulting dollars for RMB on the open market, the entity facilitating the exchange would charge the exporter a fee for its services).
64 See id. (reasoning that this fact could possibly be characterized as a transfer of money from the government to the exporter).
65 Id. at 294; see also Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft, 149, WT/DS70/AB/R (Aug. 2, 1999).
66 See Pettis, supra note 6, at 294.
67 See id.
(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance . . .

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph.\footnote{SCM Agreement, supra note 58, at art. 3.}

Footnote 4 of Article 3 explains further,

This standard 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 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.\footnote{Id.}

The United States should argue that the Chinese subsidy, in the form of currency undervaluation, is export contingent by using the Appellate Body’s holding from the WTO case of United States – Tax Treatment.\footnote{See Pettis, supra note 6, at 295; see also Appellate Body Report, United States – Tax Treatment for Foreign Sales Corporations, E-2, WT/DS108/AB/R (Jan. 14, 2002).}

In that case, “the Appellate Body held that the US’ extraterritorial income tax regime constituted a countervailable subsidy despite the fact that the tax exemption was available for goods produced in the US and for goods produced outside of the US because it overwhelmingly benefited US exporters.”\footnote{Pettis, supra note 6, at 295.} Furthermore, the Appellate Body in the United States – Upland Cotton case held “that a U.S. subsidy was export contingent even though it was also available to domestic users of cotton.”\footnote{Id.; see also Appellate Body Report, United States – Subsidies on Upland Cotton, 101, WT/DS267/AB/R (Mar. 3, 2005).}

Regarding China’s currency regime, the facts show that at least 70% of the subsidy goes to exporting companies.\footnote{Pettis, supra note 6, at 295.} Consequently, even though the subsidy is available to tourists and foreign investors, the United States could claim that the subsidy is export contingent and is thus prohibited under Article 3 of the SCM Agreement.\footnote{See id.} Put another way, even though the subsidy is available to U.S. tourists, the benefit to tourists goes directly back to the Chinese tourism industry and is

\footnote{SCM Agreement, supra note 58, at art. 3.}

\footnote{Id.}

\footnote{See Pettis, supra note 6, at 295; see also Appellate Body Report, United States – Tax Treatment for Foreign Sales Corporations, E-2, WT/DS108/AB/R (Jan. 14, 2002).}

\footnote{Pettis, supra note 6, at 295.}

\footnote{Id.; see also Appellate Body Report, United States – Subsidies on Upland Cotton, 101, WT/DS267/AB/R (Mar. 3, 2005).}

\footnote{Pettis, supra note 6, at 295.}

\footnote{See id.}
therefore prohibited. Further, the fact that a subsidy is available to foreign investors gives such investments in China a competitive price advantage, thereby conferring a benefit to Chinese exporters.  

2. IMF Articles of Agreement

First drafted at Bretton Woods in 1944, in recognition that the exchange rates and currency value policies of one country can have serious effects on the interests of other countries, the IMF Articles of Agreement are the most important tool of international monetary law and practices. Article IV and the scarce currency clause focus specifically on currency manipulation.

a. Article IV

The Second Amendment to the Articles, implemented in 1978, incorporated the current version of Article IV into the IMF Articles. Section 1 of Article IV states that the IMF was formed to “provide a framework that facilitates the exchange of goods, services and capital among countries, sustain[] sound economic growth, and continue[] the development of the orderly underlying conditions that are necessary for the financial and economic stability of each member state.” Article IV also charges the IMF with firm surveillance over the exchange rate policies of each member. Therefore, the IMF has an affirmative mandate over China’s valuation of the RMB.

Article IV, Section 1, subsection (iii) states that each member shall “avoid manipulating exchange rates . . . in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” However, nowhere in the Articles of Agreement is “manipulating exchange rates” defined. Fortunately, the IMF Executive Board’s 2007 Decision on Bilateral Surveillance (2007 Decision) provides guidance as to what may constitute the manipulation

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75 See id.
76 See Mercurio & Leung, supra note 40, at 1270.
77 See id. at 1273.
78 See id. at 1271 (stating that the amended version of Article IV reflects a shift in objective from achieving a stable exchange rate to achieving a stable exchange rate system).
79 Pettis, supra note 6, at 285; see also Articles of Agreement of the International Monetary Fund, July 22, 1944, 60 Stat. 1401, 2 U.N.T.S. 39 (hereinafter IMF).
80 See Pettis, supra note 6, at 285.
81 See id.
82 Id.; see also IMF, supra note 79, at art. IV §1(iii).
83 See Pettis, supra note 6, at 285.
of exchange rates.\textsuperscript{84} According to the 2007 Decision, possible indicators of exchange rate manipulation are:

(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 payment purposes;
(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payment 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;
(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.\textsuperscript{85}

Because China has taken action to devalue the RMB since 2001 (the year China entered the WTO), has purchased in excess of $2.2 trillion in foreign exchange reserves, and has maintained a trade surplus in the billions of dollars with the United States, the United States should argue that: 1) a protracted large-scale intervention in the exchange market to suppress the value of the RMB was carried out by China; 2) an excessive and prolonged official Chinese accumulation of US dollars, for balance of payments purposes; 3) a fundamental exchange rate misalignment of China's currency; and/or 4) a large and prolonged current account surpluses with regard to trade with the United States.\textsuperscript{86}

Furthermore, section 2 of the Annex of the 2007 Decision states the following: “A member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund determined both that: (a) the member was

\textsuperscript{85} Pettis, supra note 6, at 285-286; see also IMF Decision, supra note 84.
\textsuperscript{86} Pettis, supra note 6, at 286.
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).”

The Board also stated, “‘[m]anipulation’ of the exchange rate is only carried out through policies that are targeted at—and actually affect—the level of an exchange rate.”

The Board explained that:

(b) A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken “in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members if the Fund determines that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.”

It should not be difficult, based on the facts, for the United States to argue that China’s currency regime is “targeted at and actually affect[s] the level of the exchange rate between the U.S. Dollar and the RMB.” The circumstances also support the contention “that China has intentionally kept the value of the RMB low in order to unfairly increase the competitiveness of its exports.”

However, the IMF requirement that China had “intent to gain an unfair competitive advantage,” is a nearly impossible subjective standard to establish because it would be “politically . . . delicate for the IMF to officially find one of its members in breach of that provision.” Perhaps through more emphasis on bilateral or multilateral political cooperation within the IMF, the United States and its trade allies would be able to find the requisite intent. Additionally, if the United States was able to prove the relevant indicators of currency manipulation and intent under the 2007 Decision, the IMF would not be required to find in the United States’ favor because the relevant sections of the 2007 Decision are not binding. Moreover, even if the Executive Board of the IMF found in favor of the United States and deemed China to be engaging in currency manipulation, the United States would still have to prove that such actions were carried out in the purpose of securing fundamental exchange rate misalignment.

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87 Id.; see also IMF Decision, supra note 84.
88 Pettis, supra note 6, at 286.
89 Id. at 286-287.
90 Id. at 287.
91 Id.
92 Id. at 285, 287.
93 See id. at 287.
manipulation, the decision would be unenforceable because the IMF Agreement lacks a procedure for dispute resolution.  

**b. Article VII: The Scarcity Currency Clause**

**i. The Scarcity Currency Clause: The Text.** Article VII, section 3, of the IMF’s Articles of Agreement contains the rule regarding scarce currency. In relevant part, it states:

Section 3. Scarcity of the Fund’s holdings  
(a) If it becomes evident to the Fund that the demand for a member’s currency seriously threatens the Fund’s ability to supply that currency, the Fund, whether or not it has issued a report under Section 2 of this Article, shall formally declare such currency scarce and shall henceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall issue a report concerning its action.

(b) A formal declaration under (a) above shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange of operations in the scarce currency. Subject to the provisions of Article IV and Schedule C, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question, and they shall be relaxed and removed as rapidly as conditions permit.

(c) The authorization under (b) above shall expire whenever the Fund formally declares the currency in question to be no longer scarce.

**ii. The Scarcity Currency Clause: Analysis.** Despite the IMF’s lack of a dispute resolution mechanism, the possibility of utilizing the “scarce currency clause” of the IMF Articles of Agreement remains. The scarce currency clause would allow the IMF “to declare a currency scarce if an excess demand for it was manifest in the Fund exhausting its supplies, whereupon debtor countries would be entitled to discriminate against

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94 See id.
95 IMF, supra note 79, at art. VII §3.
payments to the country whose currency has been declared scarce.\footnote{96} Although the clause has never been invoked, if properly applied to China’s currency manipulation and its concomitant chronic trade surpluses with the United States, the international trade community could effectively encourage China to bear the burden of adjustment, that is, make China open its markets to deficit countries and recycle its surpluses through outright grants.\footnote{97} In fact, in late 2010, U.S. Treasury Secretary Timothy Geithner planned to reveal the possibility of pursuing action against China through this very channel.\footnote{98}

Since the 1944 Bretton Woods conference, and throughout the IMF’s existence, the IMF has consistently placed the burden of adjustment completely on deficit countries.\footnote{99} This practice was not what some of the IMF’s founders, including renowned British economist John Maynard Keynes, envisioned.\footnote{100} Keynes proposed the establishment of an International Clearing Union that would assess interest penalties on excess reserves above a country’s quota.\footnote{101} Keynes believed that putting the burden entirely on the deficit countries would undermine activity and world commerce.\footnote{102}

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\begin{itemize}
\item \footnote{96}{John Williamson, Getting Surplus Countries to Adjust, PETERSEN INST. FOR INT’L ECON. (Nov. 19, 2012, 10:35 PM), http://www.iie.com/publications/pb/pb11-01.pdf.}
\item \footnote{97}{See The Neoliberal Contagion, supra note 29, at 1642 (“The IMF took a ‘highly asymmetrical’ approach to adjustment by placing the major burden of policy change and adjustment on deficit countries. But that a credible threat to effectively use the scarce currency clause might pressure a surplus country to recycle its reserves to deficit countries.”); see also Timothy A. Canova, Financial Liberalization, International Monetary Disorder, and the Neoliberal State, 15 AM. U. INT’L L. REV. 1279, 1317-1318 (2000) [hereinafter Financial Liberalization] (arguing that the “scarce currency clause” and Article 12 of the WTO should be utilized “to encourage surplus countries to open their markets to deficit countries and to recycle their surpluses through outright grants” a practice that was successful during the Marshall Plan after World War II); see also Arvind Subramanian, Imbalances and undervalued exchange rates: Rehabilitating Keynes, FIN. TIMES (Nov. 9, 2008, 2:16 PM), http://blogs.ft.com/economistsforum/2008/11/imbalances-and-undervalued-exchange-rates-rehabilitating-keynes/#axzz1eBLQimhK (stating that Keynes was obsessed with getting countries with persistent current account surpluses to adjust because he was acutely aware of the limited leverage that could be exerted against such countries, thus calling for the rehabilitation of Keynes’s “scarce currency clause” by adapting it to today’s institutional realities).}
\item \footnote{98}{See Joe Weisenthal, Tim Geithner Says There’s An Old IMF Rule He Can Invoke To Punish China Over The Yuan, BUSINESSINSIDER.COM (Oct. 6, 2010), http://articles.businessinsider.com/2010-10-06/markets/30049563_1_currencies-economies-countries (reporting on an apparent speech made by Treasury Secretary Tim Geithner at the Brookings Institute, in which Geithner expresses the administration’s growing frustration with China and hints at the possibility of pursuing action under the “scarce currency clause” of the IMF Articles of Agreement); see also The Path to Global Recovery: A Conversation with Secretary of the Treasury Timothy Geithner, BROOKINGS INST. (Oct. 6, 2010), http://www.brookings.edu/events/2010/1006-global-recovery#ref-id=1006_global_recovery_geithner1 (Geithner’s ultimate speech, while reported to have hinted at possible use of the “scarce currency clause” actually omitted the relevant language).}
\item \footnote{99}{See The Neoliberal Contagion, supra note 29, at 1637-1638.}
\item \footnote{100}{See id. at 1637.}
\item \footnote{101}{See id.}
\item \footnote{102}{See id. (“Keynes claimed that the International Clearing Union plan would pressure adjustment on "any country whose balance of payments with the rest of the world is departing from equilibrium in either direction.").}
\end{itemize}
Keynes would have envisioned assessing high interest penalties on China’s excessive reserves, putting the ultimate burden on China, as a large surplus country. This would encourage China to open its markets to deficit countries, like the United States, and use its surpluses to make outright grants to such deficit countries. Keynes would fundamentally disagree with the current situation, which places the burden on countries carrying trade deficits against large surplus countries like China.

Unfortunately, Keynes’ fears have come true, with a notable example coming in the form of the IMF’s handling of Mexico’s 1982 debt crisis. The IMF conditioned its financial aid to Mexico on the adoption of a classic austerity program whereby the government deflates its economy by raising interest rates, constraining the growth of the money supply, cutting back on government spending, and raising taxes, thereby providing a classic example of the IMF’s policy of placing the entire burden of adjustment on a deficit country. Mexico’s policy, conditioned by the IMF, opened the door to “highly liquid” capital inflows, or “hot money,” laying the groundwork for a major currency crisis.

Upon increasingly negative investor speculation and domestic political instability, the “hot money” fled the country and the peso dropped in value by 50% in 1995. In response, Mexico adopted yet another IMF Stabilization Program in 1995, re-introducing many of the same policies that had caused their situation in the first place. Both the IMF’s policy of placing the burden on the deficit country after the onset of crisis and its mandated goals of currency regime stabilization and trade liberalization created the perfect conditions for a currency crisis within Mexico’s economy. This crisis had serious “adverse effects for its citizens in terms of purchasing power, cost of living, and internal...
economic stability.”\textsuperscript{108} In addition, a rising surge of migration from Mexico into the United States at this time has been largely attributed to this failed economic experiment.\textsuperscript{109}

One can find a much more mutually beneficial approach in addressing the imbalance in trade between China and the United States by revisiting the United States’ implementation of the Marshall Plan following World War II.\textsuperscript{110} Under the Marshall Plan, the United States “recycled” its surplus by giving $13 billion (roughly $130 billion in 2012) in foreign aid over four years (1947 through 1951) to Western European countries to rebuild their economies.\textsuperscript{111} Western Europe used those funds to purchase U.S. products and to pay U.S. construction companies, effectively rebuilding Western European economies, while also sustaining demand in the U.S. economy.\textsuperscript{112} Indeed, the Marshall Plan provides a perfect example of how placing the burden of adjustment on the surplus country can be beneficial for those involved.

Applying this practice to the balance of payments crisis between China and the United States, the United States, through the IMF, should invoke the “scarce currency clause”, effectively placing the burden of adjustment on China. Although no one has ever invoked this clause, the deepening payments imbalance crisis between China and the United States, and its global implications, provide the credible threat needed to pursue this route.\textsuperscript{113} Under the clause, the IMF is permitted “to identify a chronic surplus country, declare its currency as a scarce currency, and allow the rest of the world to discriminate against that country’s imports” via restrictions on current transactions.\textsuperscript{114} Used in conjunction with Article XII of the GATT, “[i]n order to safeguard its external financial position and achieve full employment, a contracting party ‘may restrict the quantity or value of merchandise permitted to be imported.’”\textsuperscript{115} In this way, international trade law could motivate chronic surplus countries, such as China, to bear the burden of adjustment, as originally envisioned by Keynes.\textsuperscript{116}

As mentioned above, there are still questions about the IMF’s ability to enforce its decisions, as it lacks an enforcement mechanism.\textsuperscript{117} The enforcement question may best be addressed through the use of the

\textsuperscript{108} Id.
\textsuperscript{109} See id.
\textsuperscript{110} See The Neoliberal Contagion, supra note 29, at 1638.
\textsuperscript{111} See id.
\textsuperscript{112} See id. at 1641.
\textsuperscript{113} See id. at 1642 (“[A] credible threat to effectively use the scarce currency clause might pressure a surplus country to recycle its reserves to deficit countries.”).
\textsuperscript{114} Id.
\textsuperscript{115} Id. at 1643.
\textsuperscript{116} Pettis, supra note 6, at 287.
WTO’s dispute resolution process. Through the so-called “Geneva Consensus,” the WTO, with the IMF’s guidance, could act as the body of enforcement, and exert pressure on China to bear the burden of adjustment by recycling its surplus to deficit countries, including the United States, while recognizing China’s right to political autonomy in other areas of trade. Such a change would be consistent with the WTO’s better record of enforcement and the overall perception that the WTO is a more effective and legitimate body than the IMF.

3. Omnibus Trade and Competitiveness Act of 1988

The Omnibus Trade and Competitiveness Act of 1988 (Trade Act) was passed by the U.S. Congress “[i]n response to earlier concerns regarding exchange rate policies of certain Asian countries and their trade with the United States and the world . . . .” While such Congressional Acts are plausible mechanisms by which the United States could confront China’s currency regime, their effectiveness is limited by their inherently unilateral nature. The additional leverage provided by a multilateral approach (i.e., the IMF), in which the U.S. acts alongside other countries affected by China’s undervaluation of the RMB, would likely prove to more effective.

The Trade Act’s applicable law states that:

The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. If the

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118 See Thomas, supra note 103, at 26 (arguing in favor of the flexibility offered by the Geneva Consensus and concluding that the Geneva Consensus might help to promote liberalization projects in developing countries); see also Subramanian, supra note 97 (“What is needed is a rule in the WTO proscribing undervalued exchange rates that are clearly attributable to government action. An undervalued exchange rate is in effect a combination of export subsidies and import tariffs, each of which is currently disciplined by the WTO. The IMF would continue to be the sole forum for broad exchange rate surveillance. But in those rare instances of undervaluation, we envisage a more effective delineation of responsibility, with the IMF continuing to play a technical role in assessing when a country’s exchange rate was undervalued, and the WTO assuming the enforcement role.”).

119 See The Neoliberal Contagion, supra note 29, at 1638.

120 See Subramanian, supra note 97 (reasoning that such a rule could be incorporated in the WTO through negotiation and by calling on a number of developing countries (Brazil, Mexico, Turkey, and South Africa) recently affected by an undervalued RMB to join in multilateral negotiations alongside the United States and the European Union with China, while addressing Chinese concerns, as the approach that has been taken for the past sixty years has failed).

121 GAO REPORT, supra note 39, at 1.

122 See Subramanian, supra note 97.
Secretary considers that such manipulation is occurring with respect to countries that (1) have material global current account surpluses; and (2) have significant bilateral trade surpluses with the United States, the Secretary of the Treasury shall take action to initiate negotiations with such foreign countries on an expedited basis, in the International Monetary Fund or bilaterally, for the purposes of ensuring that such countries regularly and promptly adjust the rate of exchange between their currencies and the United States dollar to permit effective balance of payments adjustments and to eliminate the unfair advantage. The Secretary shall not be required to initiate negotiations in cases where such negotiations would have a serious detrimental impact on vital national economic and security interests; in such cases, the Secretary shall inform the chairman and the ranking minority member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Banking, Finance, and Urban Affairs of the House of Representatives of his determination.123

Some view the Trade Act as an ineffective tool in addressing China’s currency manipulation. For example, in a 2005 Congressional Committee Report, the committee found that the U.S. Treasury enjoys “significant flexibility in making its determinations, including determining the intent of any manipulation.”124 The report indicated that U.S. Treasury officials “do not make an official determination of undervaluation as a part of their manipulation assessments although, according to their March 2005 report to Congress, they do consider measures of undervaluation.”125 Ultimately, the Congressional Committee Report concluded that “[g]iven its broad approach to impact-related analysis, Treasury’s semiannual reports do not contain discrete examinations of the effect on the U.S. economy of changes in the dollar’s value.”126 Therefore, the “Treasury’s reports do not specifically address the impact of the dollar on aspects of economic activity listed in the . . . Trade Act, including production, employment, and global industrial competition.” 127 Instead, U.S. Treasury officials stated “that China did not meet the Trade Act’s definition for currency manipulation for the purposes of Treasury’s 2003 and 2004 assessments, in part because it did not have a material global current account surplus and had maintained a fixed exchange rate regime

124 GAO REPORT, supra note 39, at 3.
125 Id.
126 Id. at 19.
127 Id.
since 1994 through different economic conditions.” While the U.S. Treasury did not report data on China’s global current account surplus from mid-2003 to mid-2004, “Treasury officials stated that the surplus had not reached a material level.”

It is not surprising that the U.S. Treasury has not found China to have a “material” global current account surplus or a “significant” bilateral trade surplus with the United States, or that China is manipulating their currency with the intent of gaining a trade advantage, given that Treasury officials enjoy significant discretion in determining intent. Treasury officials admitted that they “do not have operational definitions of a ‘material’ global current account surplus or a ‘significant’ bilateral trade surplus.” Moreover, the law requires that the country alleged to be partaking in currency manipulation carry a material global current account surplus. However, this requirement ignores the fact that the global current account balance is generally closer to equilibrium than the current account balance with any one country, a fact well illustrated by the U.S.-China trade imbalance. Even so, China carries the second largest current account surplus in the world, an estimated $201.7 billion in 2011. Thus, demonstrating that China has a “material” global current account surplus. The second requirement under the Trade Act is evident from looking at the data, which clearly illustrates China’s significant bilateral trade surpluses with the United States. Accordingly, there is ample evidence that China is manipulating its currency; however, the U.S. Treasury has consistently failed to find a violation.

For the aforementioned reasons, the Omnibus Trade and Competitiveness Act of 1988 is not a legitimate mechanism by which the United States may successfully claim that China’s currency regime is an exercise of currency manipulation. Despite the U.S. Treasury’s wide...
discretion to define crucial terms and to determine intent, there has not been an official decision that China has manipulated its currency. Perhaps, with enough pressure from Congress, the White House administration will finally feel compelled to make the requisite modifications in order to label China as a currency manipulator.

4. Currency Exchange Rate Oversight Reform Act of 2011

On Tuesday, October 11, 2011, the U.S. Senate voted 63-35 to impose new duties on imports from nations whose currency is undervalued, targeting China’s management of the RMB and its negative effects on the U.S. economy.\(^1\) The bill, called the “Currency Exchange Rate Oversight Reform Act of 2011,” was intended to force the White House to be more aggressive in seeking tariffs and other penalties against countries with “misaligned” currencies. While the bill’s future is uncertain, the Senate debate has kept the public’s focus on China’s currency manipulation.\(^2\)

Official Chinese reaction was immediate. According to one Chinese foreign ministry spokesperson, “[t]his bill seriously violates World Trade Organization rules, harms bilateral economic and trade cooperation, and does not solve the economic and employment problems in the United States.”\(^3\) Likewise, China’s Ministry of Foreign Affairs spokesperson, Ma Zhaoxu stated “[t]he passing of the act, under the pretext of so-called ‘currency imbalance,’ is a protectionist measure in [sic] nature, which severely violates the WTO rules . . . . Not only will it fail to solve the economic and employment problems in the U.S., but it will severely obstruct China-U.S. economic relations and trade.”\(^4\)

Despite wide support for the bill in the U.S. House of Representatives (House), Republican House leaders are not interested in scheduling a vote. House Speaker John Boehner considers the bill dangerous.\(^5\) Majority Leader Eric Cantor stated the House would not make a decision.

\(^{137}\) See Michael Crittenden & Bob Davis, Lawmakers Pass Bill Targeting China Yuan Policy, THE WALL ST. J. (Oct. 12, 2011), http://online.wsj.com/article/SB1000142405297020445080457662 5413832295824.html (explaining that proponents of the bill believe it will dissuade China from undervaluing the RMB, while opponents of the bill are worried that China may retaliate against U.S. firms based in China and start a trade war); see also Jennifer Liberto, Chinese Officials Blast Senate Currency Bill, CNN MONEY (Oct. 12, 2011, 7:26 AM), http://money.cnn.com/2011/10/11/news/ economy/china_currency/index.htm (reporting that the effect of the bill will be not only to increase tariffs on Chinese goods, but to discourage China’s currency manipulation).

\(^{138}\) See id.

\(^{139}\) See Liberto, supra note 137.

\(^{140}\) Id.

\(^{141}\) See id.

\(^{142}\) See id.

\(^{143}\) Crittenden & Davis, supra note 137; see also Liberto, supra note 137 (reporting that Speaker John Boehner has said that the Republican-controlled House won’t take up the bill, making Senate passage more a political exercise than an attempt at legislating).
on the bill until the White House chooses a position, something that the White House has been reluctant to formally do. President Barack Obama’s administration accused China of currency manipulation and playing the trade market, but has also expressed concern over the consequences the bill might have on U.S. obligations in China. President Obama and Treasury Secretary Timothy Geithner have expressed dissatisfaction with the pace of the RMB’s appreciation, but given the expected change in leadership in Beijing next year, U.S. officials recognize that Chinese officials are unlikely to make any substantial changes from current practice.

While Republican House leaders have expressed their skepticism about the prospect of the bill coming up for a vote in the House, notwithstanding the fact that fifteen of the sixty-three Senators to vote for the Senate bill were Republicans, there also appears to be sufficient Republican support in the House of Representatives. While House Speaker John Boehner does have the power to block the bill, the bill’s proponents claim they have enough support to pass the bill if it came to a vote. Even if the House were to pass the bill, the final decision would rest with President Obama and because the bill’s passage could result in a trade war with China, the President would have a difficult choice on his hands.

As passed by the Senate, the bill would: “[1] [F]orce the administration to . . . red-flag nations whose currencies are undervalued for long periods . . . . [2] Make it tougher for the U.S. Department of Commerce to ignore calls to investigate accusations of undervalued currencies. [3] Force the White House to give Congress a list of nations

145 See Scott Wong, Senate Passes China Currency Bill, POLITICO (Oct. 11, 2011, 6:43 PM), http://www.politico.com/news/stories/1011/65683.html (“What I would like to see is where the administration is. I mean, clearly they’ve got concerns as well….It would seem to me that it’s a big deal when you’re talking about a trading partner like China, if you do this without the input of the White House.”).
146 See Crittenden & Davis, supra note 137 (“White House officials have opposed action by Congress in the past while trying to leverage the threat of congressional action to press China for a faster rate of currency appreciation.”).
147 See Michael Pettis, China: Currency Manipulation, WALL ST. PIT (Feb. 5, 2011, 12:43 AM), http://wallstreetpit.com/60604-china-currency-manipulation [hereinafter Currency Manipulation] (“It is widely understood that during a presidential election year in the U.S. we come close to policy paralysis, with no important initiatives. It is less widely understood that in China, similarly, at least one or two years before the succession very little gets done. I think it is unlikely that we will get major moves on the currency, or on anything else for that matter. Once the new leadership is in place they will have to decide on the timing and extent of the adjustment, and I think everyone understands that it is going to be a difficult process. The current leadership won’t do it.”).
150 See id.
with ‘misaligned’ currencies.” If, after being accused of having an undervalued currency, a nation does not make sufficient effort to rebalance the currency for three months or more, then tariffs are imposed on the nation’s imports into the United States. In addition, the bill would prevent the government from buying goods and services from the violating nation, and prevent various agencies and corporations from investing in the violating nation. Furthermore, the bill allows currency undervaluation to potentially be considered a “countervailable subsidy” under the Tariff Act of 1930.

III. CONCLUSION

The range of political and legal remedies to counter China’s currency manipulation is compelling, but none have proven to be effective to date. By pegging the RMB to the USD, China is manipulating its currency—giving its exporters an unfair price advantage to the detriment of U.S. exporters and the U.S. economy as a whole. This has wiped out a large segment of U.S. manufacturing jobs and resulted in large and chronic Chinese trade surpluses with the United States.

On an international level, the WTO has a better track record of enforcement of its decisions than the IMF, largely due to the fact that the IMF lacks any independent enforcement mechanism. Under either regime, there exist tools to impose sanctions on China for its manipulation of the RMB. Through the so-called “Geneva Consensus,” the WTO, with the IMF’s guidance, could act as the enforcement body, and exert pressure on China to bear the burden of adjustment by recycling its surpluses to deficit countries, including the United States, while recognizing China’s right to political autonomy in other areas of trade.

Domestically, critics who make any effort to label China as a currency manipulator fear the political repercussions and the possibility of a trade war between the United States and China. Yet, these same critics fail to see that the United States is already in a trade war, and China is winning. China holds one of the largest trade surpluses in the world, while the United States holds the largest trade deficit. Furthermore, the United States is experiencing unemployment levels not seen since the Great Depression. Many of our elected representatives

151 Liberto, supra note 137.
152 See id.
153 See id.
155 See The Neoliberal Contagion, supra note 29, at 1638.
156 See Cent. Intelligence Agency, supra note 134.
157 See Ben Tracy, Chronic unemployment highest since Great Depression, CBS NEWS (June 13, 2011), http://www.cbsnews.com/stories/2011/06/05/eveningnews/main20069136.shtml
have recognized that these facts have not occurred by mere coincidence, but rather are inextricably linked to the U.S.-China trade imbalance. This has led to the passage of legislation, such as the Omnibus Trade and Competitiveness Act of 1988. Despite the promises of the Trade Act to address the issues of currency manipulation and bilateral trade surpluses with the United States, the Trade Act has largely failed because of unwillingness by successive administrations to follow Congressional intent in enacting it.

Congress’ frustration has led to the Senate passing the Currency Exchange Rate Oversight Reform Act of 2011 (Oversight Act). If passed by the House and signed by the President, this would impose more stringent requirements on the U.S. Treasury in addressing cases of currency manipulation and make it harder to simply skirt the problem, as has been the practice to date. There is a very real possibility that the Oversight Act will pass the House and make it to President Obama’s desk. Should this happen, the question remains whether President Obama will sign it and risk angering China or refuse to sign it and lose political points with constituents from America’s manufacturing sector. While avoiding big issues in election years is a trademark of our American political system, a recent Presidential candidate has put Chinese currency manipulation at the forefront. Republican Presidential candidate Mitt Romney promised that he would label China as a currency manipulator in his first day in office, and that he would impose tariffs on Chinese imports to the United States that are being subsidized by the manipulation. Yet, we will not get to see Mitt Romney fulfill his promise, Barack Obama having won his second term in November 2012. Whether or not this is mere political posturing, it is clear that the political conversation regarding Chinese currency manipulation has come to the forefront.

Considering all the approaches discussed above, the practice of imposing the burden of adjustment on the surplus country, as proposed by Keynes, seems the most compelling approach to our current predicament. The Marshall Plan provides an example of how such a practice can be mutually beneficial to all involved. This approach would best be achieved by invoking the “scarce currency clause” of the IMF Articles of Agreement. Under the clause, the IMF could identify China as a chronic surplus country, declare the RMB as a scarce currency, and allow the rest of the world to discriminate against China’s

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159 See id.
imports via restrictions on current transactions.\footnote{See id.} In this way, the IMF would be acting within its purview and honoring Keynes’ vision.

Critics cite the IMF’s unwillingness to impose strict timelines on China’s adjustment of RMB valuation, the IMF’s lack of enforcement mechanism, and the fact that the “scarce currency clause” has never been invoked. Yet, there is reason to be guardedly optimistic with the possibility of a successful U.S. claim that China has violated the “scarce currency clause.” Not only does the U.S. Treasury play a large role in the policy of the IMF, but the United States is the sole IMF member with the power to veto any negative IMF decision. Furthermore, by cooperating on a multilateral level with Europe and other countries affected by Chinese currency manipulation, the United States could increase the likelihood of finding a Chinese “scarce currency” violation. Finally, as mentioned above, by applying the “Geneva Consensus” approach, the WTO, with the IMF’s guidance, would provide the necessary pressure to finally force China to open its market to the United States, and use its surpluses to make grants to the United States, effectively placing the burden of adjustment on China.