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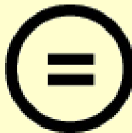

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국제학석사학위논문

China's Currency subsidies, the next front of the trade war:

A legal analysis on the consistency of WTO SCM agreement

미·중 무역전쟁의 새로운 전선, 환율 보조금:

WTO 보조금 협정과의 합치성 분석을 중점으로

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서울대학교 국제대학원

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China's Currency subsidies, the next front of the trade war:
A legal analysis on the consistency of WTO SCM agreement

A thesis
Submitted to the Graduate School of International Studies
at Seoul National University
in partial fulfillment of the requirements
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Soo Ryung Park

August 2021

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ABSTRACT

China's Currency subsidies, the next front of the trade war:
A legal analysis on the consistency of WTO SCM agreement

Soo Ryung Park

The U.S. has been criticising China's undervalued currency exchange rate as the principal reason for the widening trade deficits with China. Since the 2008 global financial crisis, the U.S. has suffered from mass unemployment and currency account deficits with emerging countries. During that period, the U.S economic recession contrasted sharply with China's average growth rate of 9 per cent. The U.S. has sought to address exchange rate issues through multilateral and bilateral channels; however, it has remained largely unfulfilled by the limitations of its existing IMF and WTO roles and the lukewarm attitude from other countries. President Trump, who took office in 2017, however, strongly condemned China's currency manipulation problem, unlike the previous administration, signalling a strong U.S. response. In 2019, he kept his promise with a designation of China as currency manipulation for the first time in 25 years. In February 2020, the U.S Department of Commerce (USDOC) announced its publication of new countervailing duties (CVD) regulation to address the issue of the foreign products benefitted from undervalued currency. This final rule provides a legal basis to the USDOC to counter a foreign country's currency manipulation practices through CVD proceedings.

However, whether the USDOC's CVD ruling is in accordance with the WTO agreement is one of the remaining issues to be considered. WTO Subsidies and Countervailing Measures (SCM) Agreement is often mentioned as the relevant agreement to address the currency manipulation issue. However, Since the WTO dispute settlement body does not have any experience of dealing with a dispute case with the issue of currency manipulation, it is still controversial to conclude that the currency manipulation is in violation of international trade rule. The new CVD rule, therefore, raises legal issues whether a currency manipulation can meet the three conditions to be considered as a subsidy under the SCM Agreement: "financial contribution by a government", "benefit", and "specificity". In this regard, this research aims to conduct a legal analysis on the US's Federal regulation amendment to levy countervailing duties against the undervalued Chinese currency as to its consistency of WTO obligations under the SCM Agreement. Furthermore, the current international economic law such as WTO and IMF are challenged because they fail to provide an overarching framework to address or regulate currency manipulation. Thus, this research also aims to address possible strategies to counter currency practices multilaterally and bilaterally.

Keywords: US-China trade war, currency manipulation, subsidy, WTO, ASCM.

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LIST OF ABBREVIATIONS

AREAER	**Annual Report on Exchange Rate Arrangements and Exchange Restrictions**
ASCM	**Agreement on Subsidies and Countervailing Measures**
CFETS	**China Foreign Exchange Trade System**
CFR	**Code of Federal Regulations**
CVD	**Countervailing Duty**
GATT	**General Agreement on Tariffs and Trade**
GDP	**Gross Domestic Product**
IMF	**International Monetary Fund**
PBOC	**People's Bank of China**
USDOC	**United States Department of Commerce**
USDOT	**United States Department of Treasury**
WTO	**World Trade Organisation**

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I. Introduction

1. Background of US-China Currency War

‘Currency manipulation’ is an intentional undervaluation of domestic currency to get a comparative advantage in the international market and it has been a serious concern to policymakers and analysts. Especially, the United States suspected some foreign countries exchange rate policies of being undervalued, which harms US current account deficits and induces job losses. Among many economists, policymakers and business leaders, there was a consensus that China deliberately weakens the value of its currency to maintain export-led growth strategy by gaining comparative advantages in the international competition. In order to address the issue, the Congress members had suggested designating China as a ‘currency manipulator’ so that they can force China to appreciate its currency. In addition, more than 100 bills were issued to congress in this regard. Despite the domestic efforts to address the currency manipulation practices, the US administration before the previous president Trump did not take any practical measure in an offensive manner.

Under the leadership of President Trump, however, the U.S forged ahead with currency manipulation, arguing that the alleged undervaluation of currency constitutes a subsidy that provides Chinese exporters to ride a wave of unfair trading advantage, which even further widens the trade deficit gap with the U.S. In 2019, under the 1988 Trade Act, the U.S labelled China as a currency manipulating country. It was the very

first designation in U.S history. However, the decision which took 25 years was abolished after the US and China signed the "phase one" trade deal in January 2020 (Snutter, 2021). As the US lifted the decision of currency manipulator designation, the exchange rate issue between the US and China seems to reach a state of the lull. On 4 February 2020, however, just a month later after the phase 1 trade deal, the U. S. Department of Commerce (DOC) announced a new CVD rule that allows countervailing duties proceedings against currency manipulation and the rule took effect on April 6.[1] Based on the new CVD rules, USDOC initiated the CVD investigation and issued affirmative preliminary CVD determination for passenger vehicles and light truck (PVLT) tires from Vietnam and Twist Ties from China. Despite the affirmative preliminary CVD determination, it is uncertain whether President Joe Biden will impose the CVD on both countries. Nonetheless, the President announced that he will show 'more continuity than expected' from Trump policy on China. Therefore, the conflict between undervalued currencies is likely to continue under the new presidency.

2. Purpose of Research

This research aims to conduct a legal analysis on the USDOC amendment of the CVD rule to levy countervailing duties against undervalues Yuan is in accordance with the WTO ASCM. The legal analysis was based on the industrial comments on USDOC's CVD rule and the research done by Kim(2021) and Lee(2021). Furthermore, the current

[1] See USDOC. "Modification of Regulations Regarding Benefit and Specificity in countervailing Duty Proceedings". 85 FR 6031(4 February 2020) (effective as of 6 April 2020).

WTO regime is challenged due to its limitation in addressing foreign exchange rate policies (Jung, 2012). Thus, this research also aims to address possible strategies to counter currency practices under the WTO agreement and through bilateral countermeasures. This paper is mainly divided into five chapters. For the chapter 2, a brief overview of Chinese's exchange rate regime and the history of the U.S-China currency conflict will be mentioned. The chapter 3 illustrated the existing policy framework regarding currency manipulation. This chapter firstly discussed multilateral frameworks so-called IMF and WTO agreement. Then, three provisions in the U.S. law to address the issue of undervalued currency were mentioned. Moving on the to the chapter 4, the consistency of the new CVD rule of the DOC with the WTO SCM Agreement is legally analysed. Based on the finding that existing policy frameworks lack the authority or comprehensive instrument to deal with the currency issue, Chapter 5 suggests possible strategies to counter currency manipulation. The strategies are divided into two approaches: the Multilateral/Plurilateral approach and the Bilateral/Unilateral approach. In the conclusion, it summarized all the discussion above and draw implications of the currency dispute.

II. Overview of Exchange Rate Dispute

1. Overview of China's Exchange Rate Regime

The "Annual Report on Exchange Rate Arrangements and Exchange Restrictions" (AREAER)[2] of the IMF categorized the exchange rate arrangements into four groups: hard pegs regime, soft pegs regime, floating regimes, and residuals (see *Table 1*). Referring to the International Monetary Fund (IMF)'s AREAER[3], China's foreign exchange policy has undergone gradual reform over the past decades.

Table 1. Classification of Exchange Arrangements

Type	Categories				
Hard pegs	Exchange arrangement with no separate legal tender	Currency board arrangement			
Soft pegs	Conventional pegged arrangement	Pegged exchange rate within horizontal bands	Stabilized arrangement	Crawling peg	Crawling-like arrangement
Floating regimes (market-determined rates)	Floating	Free floating			
Residual	Other managed arrangement				

**The IMF's exchange rate classification system was revised on February 2, 2009*
Source: IMF(2019)

[2] See IMF, "Annual Report on Exchange Arrangements and Exchange Restrictions 2019". (2020.08)
[3] See IMF, 2020, 2019, 2018, 2016, 2015, 2014, 2013, 2012, 2011, 2010, 2009, 2008, 2007, 2006, 2005, 2004, 2003, 2002, 201, 2000 etc

From 1994 until July 2005, China's exchange rate system maintained a fixed exchange regime at a rate of 8.28 RMB with respect to a US dollar. The Bush administration, which blamed China for the huge U.S. trade deficits at the time, strongly demanded China to reform its currency system. Along with the pressure from trading partners and the IMF, on July 21, 2005, China underwent the radical reform, converting their pegging RMB rate depending on the U.S. dollar to a crawling peg to the U.S dollar[4]. Since the outbreak of global financial crisis in 2008, China returned to the old regime pegging 6.8 RMB to a US dollar for two years. From June 1, 2008 to June 21, 2010, China's exchange policy was reclassified as 'a stabilized arrangement'. In 2010, there was a sufficient pressure from the international organization to halt the pegged system and appreciate the undervalued Chinese currency. On July 27, 2010, the IMF announced its analysis that the Chinese RMB needs an appreciation as its value is "substantially below the level that is consistent with the level of medium-term fundamentals". In response to the international criticism, China changed its foreign exchange rate system to a 'crawl-like arrangement' in proportion to the U.S dollar. From December 24, 2014, IMF reclassified China's foreign exchange rate system into "other managed arrangement" which falls under a residual category distinct from other three regimes. (Yu, 2018).

In 2015, 13 countries foreign exchange rate indices were published by the China Foreign Exchange Trade System (CFETS) to remove allegation that Chinese Yuan

[4] The People's Bank of China, declared that China was "moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies."(Ito, 2008;Wei, et al., 2021) Then existing category of 'managed floating' was replaced with 'floating' under the new version of the IMF's exchange rate classification system revised in 2009.(Yu, 2018)

was only determined by the U.S dollar (CFETS, 2015). China was reclassified retroactively to a crawl-like from other managed arrangement on 11 November 2015(IMF, 2020). In the AREAER for 2019, from June 22, 2018 china returned to ‘other managed arrangement’, namely residual category. This category is for exchange rate arrangements with frequent changes (Yu,2018).

Table2. China's Evolving De facto Exchange Rate Regime (IMF classification)

Effective Date of reclassification	***De fecto* Category**	***Remarks***
~ 1994	A dual exchange rate system	
January, 1994	Conventional pegged arrangement	China unified its dual exchange rates and pegged RMB to the USD at 8.28
August 1, 2006	A crawling peg	RMB was permitted to appreciate by 2.1% against the USD crawling peg
June 1, 2009	A stabilized arrangement	The CNY peg to the USD at 6.83
June 21, 2010	Crawl-like arrangement	The rate has remained in a 2% crawling band
December 24, 2014	Other managed arrangement	*De jure* Managed floating
August 24, 2016	A stabilized arrangement	
June 01, 2017	Crawl-like arrangement	
June 22, 2018	Other managed arrangement	

Source: IMF, 2020,2019,2018,2016,2011,2007

Figure 1 illustrates the changes of the exchange rate of U.S dollar-Chinese RMB since 2000. The vertical lines are the years that china changed its exchange rate policy (Mertens and Shultz, 2017). During the hard peg from 2000 to 2005, exchange rates remained. Between 2005 and 2008, China permitted its currency RMB to appreciate by 2.1% against dollar. Thus during these period, China showed the movement of their system to crawling peg respecting to the U.S dollar. After global financial crisis in 2008, China readopted the original system, so called a fixed exchange rated so that the currencies were stabilized between 2008 and 2010. In 2010 as China changed the policy again to the crawl-like arrangement, however, the fluctuation of its value increased consequently. To maintain the past value of the RMB when it was in the pegged system with respect to the U.S. dollar, the central bank of China, the People's Bank of China (PBOC), intervened in its exchange rate market by selling RMB for U.S dollars to avoid the appreciation of its currency (Mertens and Shultz, 2017).

Whether the RMB is substantially undervalued is a controversial issue among politicians and economists. In the U.S there is a general agreement that the China enjoys the competitive advantages by keeping RMB at artificially low levels. On the other hand, Gagnon (2020) argues that since 2016 there is no clear evidence that shows China's intervention in its exchange rate system, and its current account surplus remains less than 2 percent of GDP during the recent 4 years. Despite the lack of evidence to accuse China as a currency manipulation, China's RMB has been a frequent concern in the political and economic spheres in the US because China has been one of the major trade partners of the U.S. For now, the U.S. lacks ability to fully address or counter China's exchange

rate system issue; however, the U.S. is likely to maintain its policy stance of using the exchange rate as available tool to address large trade imbalances (Mertens and Shultz, 2017; Gagnon, 2020).

Figure 1. U.S. dollar – Chinese RMB exchange rate in 20 years

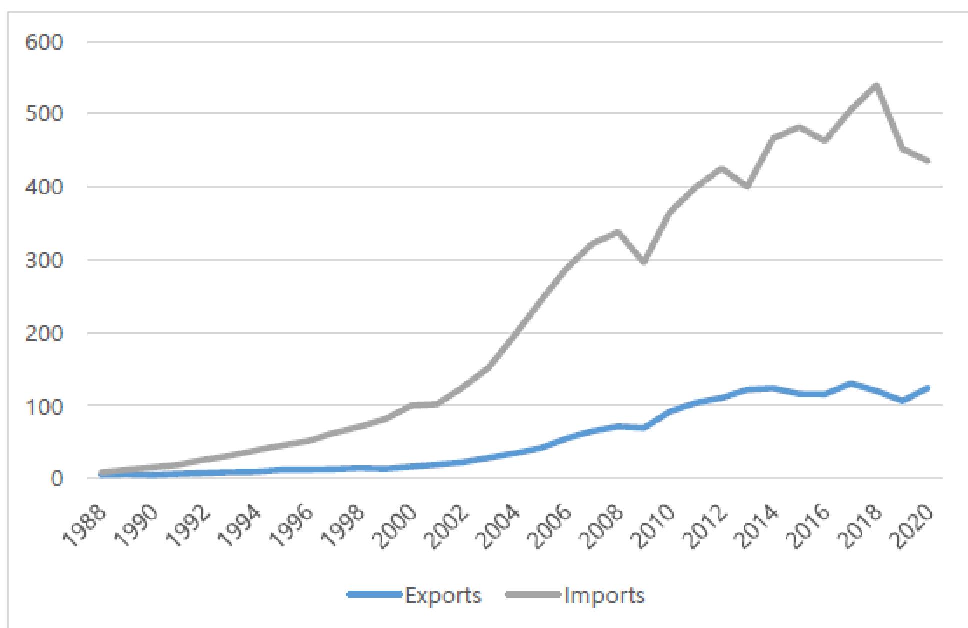
Source: Macrotrends, 2021

2. History of U.S-China Currency Dispute (1980-2021)

The U.S. – China trade conflict had escalated under the Trump administration. This situation is reminiscent of the U.S. "Japan bashing" in the 1980s. As the U.S. trade deficit with Japan soared, the U.S led the Plaza Accord to appreciate the Japanese Yen respecting to the U.S dollar to curtail the U.S trade deficit and the agreement was signed on September 22, 1985. As a result, the strong yen threw Japanese economy to flounder into "Lost Decade" of sluggish growth and deflation.

Analogously to the situation of the 1980s, there is a general consensus that the accumulation gof the U.S trade deficit with China is the core reason of the recent U.S-China trade dispute. The United States had been taken various measure to combat the financial distortion from China's currency undervaluation. According to *Figure 2*, from 1980s the U.S. trade deficit with China was consistently elevated. In 2000s, the gap between export and imports has been further widened, recording 419 billion USD of deficit with China in 2018.

Figure 2. A long-term view on U.S. trade with China since 1988 (Unit: Billion USD)



Source: KITA, 2021

Since 2010, scholars and experts in the U.S. have been discussing whether foreign countries' currency undervaluation can be offset through CVD proceedings (Nelson and Casey, 2020). The Congress members had issued more than 100bills in regard to the issue of currency manipulation but most of them have not been legislated (Albasoos, 2016). [5] In November 2011, President Obama urged China to adjust their exchange rate policy to market-oriented system (Whitesides, 2015; Albasoos, 2016). Furthermore, during President Obama term, senior U.S. lawmakers also criticised China's unfair

[5] Bills which were not legistered are followed : "Currency Exchange Rate Oversight Reform Act of 2007(S. 1607); Currency Exchange Rate Oversight Reform Act of 2009(S. 1254)"; "Currency Exchange Rate Oversight Reform Act of 2007 (S.3134)"; "Currency Exchange Rate Oversight Reform Act of 2011 (S. 1619)"

currency practice as "provocative action" to the U.S. (Howard, 2016; Albasoos, 2016). As they believe that U.S economy was adversely affected by the China's currency undervaluation, they also argue that the U.S should consider it more seriously and respond more aggressively.

As Donald Trump took office on 20 January 2017, he declared to name China as a currency manipulating country. This action was intended to draw the attention of not only U.S. public but also China (Howard, 2016). Finally, in 2019, the DOT designated china a currency manipulating country, claiming that "China has taken concrete steps to devalue its currency" under the "Omnibus Trade and Competitiveness Act of 1988"[6]. This was the first official designation by the US government; however, the U.S. took its word back after they signed "phase one" trade deal with China in January 2020. According to the language of the phase one, both parties shall "maintain a market-determined exchange rate"(Gagnon, 2020). However, if we consider the past unbinding U.S. policy and China's continuous intervention in the exchange rate system, it would not be promising to expect market-determined exchange rate in China (Gagnon, 2020).

On 4 February 2020, USDOC issued a new CVD rule to cover the issue of currency manipulation as a countervailable subsidy and it came into effect on April 2020.[7] The new CVD rule provides a legal basis for the DOC to investigate foreign country's currency practices through the Commerce CVD measures and this is the first official action from the U.S. to treat the issue of currency manipulation (Lee, 2021). The new

[6] See USDOT, Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States (2019,5) and USDOT "Treasury Designates China as a Currency Manipulator. 2019.8

[7] See USDOC. "Modification of Regulations Regarding Benefit and Specificity in countervailing Duty Proceedings." 85 FR 6031(4 Feburary 2020)(effective as of 6 April 2020).

rule is a modification of the existing CVD regulations, which add new languages so that USDOC can evaluate an undervalued foreign currency as a subsidy which can be countervailable (CRS, 2020). Based on the new rule, the DOC issued CVD orders on PVLT tires from Vietnam and Twist ties from China.[8]

Table 3. Timeline of the US-China currency conflict

Date		Event
2007	-	Proposal of the Currency Exchange Rate Oversight Reform Act of 2007 (S.1607)
2009	-	Proposal of the Currency Exchange Rate Oversight Reform Act of 2009 (S. 1254)
2010	-	Proposal of the Currency Exchange Rate Oversight Reform Act of 2007 (S.3134)
2019	Aug	Designated China as a "currency manipulator" pursuant to Section 3004 of the Omnibus Trade and Competitiveness Act of 1988
2013	Jan	Lifted the designation
2019	Jan	DOC initiated a CVD investigation on Twist Ties from China
2020	Feb	Amended a new CVD rule to address currency manipulation as a countervailable subsidy.
2020	May	DOC initiated a CVD investigation on PVLT tires from Vietnam
2020	Nov	DOC issued preliminary determination on PVLT tires from Vietnam
2020	Dec	DOC issued preliminary determination on Twist ties from China
2021	April	DOC issued CVD orders on Twist ties from China
2021	May	DOC issued CVD orders on PVLT tires from Vietnam

Source: Compiled from FEDERAL REGISTER

[8] See 85 FR 77167 for China case and 86 FR 28566 for Vietnam Case

III. Existing Policy Framework

The IMF and WTO, two distinguishing international economic organisations, share the principle goals such as the promotion of world economy and international trade balance. These two main international organizations act in a complementary and cooperative manner in dealing with international finance and trade. These organizations have a different approach regarding currency manipulation. Even if the IMF prohibits currency manipulation in pursuit of a competitive advantage in doing trade, the IMF cannot legally enforce a ban on the modification of member countries' exchange rate policy. Due to the absence of legal binding of the IMF, the World Trade Organization's dispute resolution, which has relatively strong implementation procedures, such as granting retaliatory authority, has been raised as a more effective alternative.

1. Manipulation of Exchange Rate in International Law

1-1. *IMF*

The IMF, the international organization to supervise the global financial and monetary policy, was established to "facilitate the expansion and balanced growth of international trade." In 1987, IMF amended its Article which allow member countries from adopting any type exchange rate system under the certain guideline (Sanford, 2011). "Article IV Obligations Regarding Exchange Arrangements" of the IMF Agreement, which was also amended in 1987, is a relevant provision to the currency manipulation. Article IV reads:

> "Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, […], each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:
>
> (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
>
> (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
>
> (iii) 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; and
>
> (iv) follow exchange policies compatible with the undertakings under this Section."[9]

There are two areas in which the IMF's role and authority in currency manipulation can be inferred through the above-mentioned provisions. First, Article IV, Section 1 requires each member state to "collaborate with the Fund and other members to assure the orderly exchange arrangements and to promote a stable system of exchange rates"(Pettis, 2011a). However, the currency manipulation practices are more likely to impede the stableness of exchange rate system globally; thereby it is a opposite to the pursuit of the article. This is because one country's manipulation act may give incentives to the neighbouring countries to counter disadvantage by adopting same manipulation strategy (Bergeten and Gagnon, 2012). Secondly, Article IV, Section 1, subsection (iii) obligates member states not to "manipulate exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair

[9] Full text available at: "General Agreement on Tariffs and Trade.", art. XV.. Section4

competitive advantage over other members"(Denters, 2003). This language is more precise than the first one as it clearly mentions not manipulate exchange rate. However, Article IV fails to provide an agreed definition of the "currency manipulation" (Pettis, 2011a).

Regarding the IMF's definition of the "currency manipulation", The IMF Executive Board's "2007 Decision on Bilateral Surveillance (2007 Decision)"[10] fills the gap of the Article IV by providing standards for currency manipulation (Pettis, 2011a). Section 15 of the 2007 Decision provides 7 possible standards to indicate currency manipulation.[11]

However, the guidance in the 2007 Decision has two limitations to be considered as an effective provision to address the issue of currency manipulation. First, 2007 Decision are not legally binding. Second, the guidance is rather subjective than objective as it fails to provide numerically accurate standards. In addition to that, many people

---

[10] "The 2007 Decision on Bilateral Surveillance over Members' Policies (Review of the 1977 Decision on Surveillance over Exchange Rate Policies)" was first adopted in 1997 and it was reviewed and updated in 2007

[11] On June 21, 2007, IMF Executive Board published "New Decision on Bilateral Surveillance" and listed 7 possible standards to indicate currency manipulation. See below for the standards:

> " (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;
> (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."

warn that IMF's official designation of its member countries as a currency manipulator will be very difficult because of political difficulties among the IMF member countries.

As discussed above, IMF shows the institutional limitations to deal currency manipulation affirmatively. Also, IMF even fails to classify or define the act of currency manipulation with vague guidance. The most critical limitation of the IMF, however, is that it does not have a dispute resolution procedure which are legally binding (Seigel, 2002). Therefore, even if the IMF determine that a country was manipulating exchange rate, there is no possible countermeasure because the IMF lacks legal mechanisms to take an action to counter the currency issue (Pettis, 2011a). The IMF role is limited to provide economic advice and arrange consultation or discussion on the issue of exchange rate dispute (Sanford, 2011).

1-2. WTO : GATT and ASCM

WTO, a major international trade organization established in 1995, is the other international legal framework to cope with the issue of currency manipulation; because the effect of currency manipulation affects trade relations (Denters, 2003). The uniqueness of the WTO as a major international trade organization is a binding mechanism. Differently from IMF, WTO has a dispute settlement system that can enforce its rules (Seigel, 2002; Denters, 2003). Especially, Article 15 of the GATT and WTO ASCM are often discussed to address currency undervaluation.

China's currency manipulation under the GATT

Article XV of the GATT address the issue of exchange rate and trade. Section 2 and Section 4 of Article XV are most relevant here. First, Section 2 of Article XV provides that:

> "In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund […]"[12]

This provision states the necessity to "consult with the IMF" when the contracting parties try to deal with issues such as "monetary reserves, balances of payments or foreign exchange arrangements". In addition, it also obliges the member states to accept the IMF determination of the issue as to whether the action of manipulation consistent with the IMF.

The other provision to note is Section 4 of Article XV. Article XV, Section 4 provides that:

> "Contracting parties shall not, by exchange action, frustrate […], the intent of the provisions of the Articles of Agreement of the International Monetary Fund."[13]

Article XV, Section 4 prohibits member countries from discoursing the intent of the WTO and IMF provisions by exchange action. If the complaining party wants to invoke Article XV, Pettis (2011a) argued the complaining country should prove two key

[12] Full text available at: "General Agreement on Tariffs and Trade.", art. XV. Section2
[13] Full text available at: "General Agreement on Tariffs and Trade.", art. XV.. Section4

issues to a dispute settlement system of the WTO. The first issue is to prove a country's currency manipulation is in the scope of the term "exchange action" under Article XV (Pettis, 2011a). The term 'exchange action' can be inferred as currency manipulation or other unfair exchange rate practices. However, Article XV does provide a clear definition of "exchange action". If the first condition is proved, then the second issue to prove is whether this currency manipulation "frustrates" the intention of the GATT (Pettis, 2011a). GATT provides neither the definition of "frustrate" nor the guidance to interpret the term. Furthermore, there is no case where the panel of the WTO dispute settlement body interpreted Article XV, Section 4 (Miranda, 2010). This means that there is no precedent dispute case that could be used as guidance to invoke Article XV in regards to the currency manipulation issue. Moreover, it is controversial to make an estimate on the DSB's finding; thereby difficult to be assured about the adequacy of this approach (Pettis, 2011a).

China's currency manipulation as subsidy under the SCM agreement

The WTO SCM Agreement could be invoked as a possible solution to address the issue of currency manipulation as a form of *de facto* subsidy to exporters from currency manipulating countries (Denters, 2003). It is often agreed that a currency undervaluation reduces the price of exporting items; therefore, it performs the same role as export subsidies by giving a competitive price advantage. Therefore, if WTO found that a currency undervaluation is a form of subsidies, complaining parties can impose CVD on

imported products (Sanford,2011). However, it is still controversial whether currency manipulation meets the definition of subsidy under the WTO agreement.

Article 1.1 of the SCM Agreement states an overarching definition of a "subsidy" as:

> "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 or
> (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) a benefit thereby conferred"

Referring to the provided definition, subsidy exists if the three conditions are met: "financial contribution by a government" and "a benefit thereby conferred".[14]

Furthermore, Article 2 of the ASCM Agreement lists out the third condition for the subsidy, 'Specificity'. Article 2.1 states the scope of the term 'specificity'. It provides that:

> "2.1 In order to determine whether a subsidy, [...], is specific to an enterprise or industry or group of enterprises or industries [...] within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
> (b) 2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific."

[14] According to the "Brazil-Aircraft case (DS46)" and the" Canada-Aircraft case (DS70)", both the panel and Appellate body determined that 'financial contribution' and 'benefit' are two legal elements to determine the existence of a subsidy. For detail see Appellate Body Report, Brazil – Export financing Programme for Aircraft, WT/DS46/AB/R (Aug. 20, 1999) and Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R(Aug.20,1999).

According to Article 2.1 of the Agreement and the WTO website, the SCM agreement classified 'specificity' into 4 types: Enterprise-specificity, Industry-specificity, and Regional Specificity. Thus, for currency manipulation to be deemed as countervailable subsidies under the ASCM, it should meet the three conditions: 'financial contribution", "benefit", and "specificity".

However, export subsidy[15] is automatically considered to be specific so that it only has to meet the two conditions except "specificity" (Bossche and Zdouc, 2017). As stated in Article 3.1(a)[16], a subsidy is "contingent upon export performance". Thus, if currency manipulation is classified as an export subsidy, it only has to prove the existent of 'financial contribution' and 'benefit'.

2. Unilateral Approach: Provisions in U.S. Law

2-1. Omnibus Trade and Competitiveness Act of 1988 Section 3004

Under "Section 3004 of the Omnibus Trade and Competitiveness Act of 1988", the USDOT was first mandated to publish "Semi-annual reports on exchange rate policies of foreign countries". The report analyses "whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of

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[15] Export subsidies[15] are categorised as prohibited subsidies under the WTO Agreement (ITA, 2021; Institute For Government, 2021; WTO, 2021). For the list of export subsidies, see ASCM Annex I: Illustrative List of Export Subsidies.

[16] Article 3 Prohibition 3.1(a) provides that:

> "3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;"

preventing effective valance of payments adjustments or gaining unfair competitive advantage in international trade" (Picone, 2019). Section 2004(b) of the act listed three general criteria: (1) "A significant bilateral trade surplus with the United States"; (2) "A material currency account surplus"; and (3) "Manipulate the rate of exchange for the distorted purposes." (Picone, 2019; Public Citizen Policy Brief, 2018). However, the criteria are too broad to determine the act of manipulation specifically.

After the enactment of the legislation, the Department of Treasury initially identified Taiwan and Korea as currency manipulators in 1988. In 1992, Taiwan was also cited as a currency manipulator with a new designated country, China. Between 1995 and 2018, the DOT had never labelled any foreign country as a currency manipulator according to the 1988 Trade Act (Nelson, 2020). After 25 years from 1995, On August 5, 2019, the Treasury Department under the Trump administration designated China to be a currency manipulation citing Section 2004 of the 1988 Trade Act. The statement on August 5, 2020, by the Treasury Department, declares that China has been devaluing its currency and its purpose is "to gain competitive advantage in international market" (USDOT, 2019). In the "Annual Report on Exchange Arrangement and exchange restrictions" published in December 2020, the Treasury Department determined that China is currency manipulators, as well as Switzerland and Vietnam.

Section 3004 not only designates currency manipulators but also enables Treasury Secretary to initiate negotiation with manipulating countries (Picone, 2019). Section 3004. (b) states the purpose of negotiation is to " promptly adjust the rate of exchange between their currencies and the United States dollar to permit the effective

balance of payments adjustments and to eliminate the unfair advantage."[17] However, the designation within the scope of section 3004 of the 1988 Trade Act is largely symbolic for two reasons. First, the designation under section 3004 is not connected to the countervailing duty statute (Picone, 2019). Second, the only remedy approved under the 1988 Trade Act is the bilateral negotiations. Therefore, the 1988 Trade Act does not provide any binding measures to remedy unfair exchange rate manipulation practices.

2-2. Trade Facilitation and Trade Enforcement Act of 2015

In February 2016, the Congress passed "Trade Facilitation and Trade Enforcement Act of 2015".[18] In order to secure a fair trade environment, the act discusses important trade issues other than currency manipulation, such as intellectual property rights and health and safety (Lovells, 2016). Specifically, Title VII of the Act states currency undervaluation related issues (Hamil, et al., 2016).

Title VII, Section 701, paragraph 1 of the Act requires the DOT to submit a report to the congress on "Macroeconomic and currency exchange rate policies of major trading partners" of the United States once every 180 days. Therefore, Treasury publishes the "semi-annual Report on Foreign Exchange Policies of Major Trading Partners" in response to the 1988 and 2015 Act. Especially, Section 701 of the Act specified three criteria to determine the currency manipulation from third trading

[17] Full Text is available at: "Omnibus Trade and Competitiveness Act of 1988", Section.3004. (b)Bilateral Negotiations.
[18] It is the first legislation which gives full authority to U.S. Customs and Border Protection(CBP)(CBP, 2021) Full text is available at: H.R.622- Trade Facilitation and Trade Enforcement Act of 2015. https://www.congress.gov/bill/114th-congress/house-bill/644/

partners: “1) a trade surplus with the U.S. that exceeds $20 billion 12 months; 2) a current account surplus of at least 2% of GDP over that period; and 3) net purchases of foreign currency equaling at least 2% of GDP over 12 months”(CRS,2020; Kim and Na, 2017).

Under the 2015 Act, DOT (2021) has to provide a Monitoring list, which records major partners. This list requires careful monitoring for their currency practices. If Countries meet the two criteria of currency manipulation, they will be on the Monitoring List (USDOT, 2021). While those who satisfy all three criteria under the Trade Enforcement Act is determined as a currency manipulator. *Table 4* shows the determined monitoring list and currency manipulator from 2016 to 2021. China has been included in the monitoring list from 2016 to 2021 under the 2015 Act. However, China was never determined as a currency manipulation under the 2015 Act as China did not meet all three criteria. On the other hand, Vietnam and Switzerland were designated as currency manipulators in December 2020, the first and only such designation to date (CRS, 2020).

Table 4. The Treasury Department's FX report

Year	Month	The Monitoring List	Currency Manipulator
2016	April	China, Japan, Korea, Taiwan, and Germany.	-
	Oct	China, Japan, Korea, Taiwan, Germany, and Switzerland.	-
2017	April	China, Japan, Korea, Taiwan, Germany, and Switzerland.	-
	Oct	China, Japan, Korea, Germany, and Switzerland	-
2018	April	China, Japan, Korea, Germany, Switzerland, and India	-
	Oct	China, Japan, Korea, India, Germany, and Switzerland.	-
2019	May	China, Japan, Korea, Germany, Italy, Ireland, Singapore, Malaysia, and Vietnam	-
2020	Jan	China, Japan, Korea, Germany, Italy, Ireland, Singapore, Malaysia, Vietnam, and Switzerland	-
	Dec	China, Japan, Korea, Germany, Italy, Singapore, Malaysia, Taiwan, Thailand, and India	Vietnam, Switzerland
2021	April	China, Japan, Korea, Germany, Ireland, Italy, India, Malaysia, Singapore, Thailand, and Mexico	-

Source: Department of Treasury, 2021, 2020, 2019, 2018,2017, 2016

Countries listed on either the monitoring list or currency manipulator are subject to enhanced bilateral engagement by the Department of Treasury. After enhanced bilateral engagement begins, the trading partners should adjust their policy to clear the charge of currency undervaluation within one year (Picone, 2019; Lincicome and Picone, 2019). If they fail to correct the unfair practice, the President may take a variety of steps, such as restricting overseas private investment corporations from the approval of new financing products relating to the accused trading partners (Hjelm, et al., 2016). The specific remedial actions are listed on *Table 5*. Differently from the 1988 Act, which

only authorises the initiation of negation in the IMF or bilaterally, the 2015 Act provides a legal basis for the four different ways to impose sanctions against the countries in question. The imposed sanctions can be only withdrawn if the president determines imposition of remedy action might cause a negative effect on the domestic economy (Hjelm, et al., 2016).

Table 5. The comparison between the 1988 Act vs. the 2015 Act

	1988	2015
Report	Mandate the department of Treasury to publish a report on semi-annually.	
Three Criteria	(1) a significant bilateral trade surplus with the United States (2) a material currency account surplus	(1) a trade surplus with the U.S. that exceeds $20 billion over a 12-month period (2) a current account surplus of at least 2% of GDP over that period (3) net purchases of foreign currency equaling at least 2% of GDP over 6 months
Remedial Action	(1) Initiate negotiations in the IMF or bilaterally	(1) Prohibit the Overseas Private Investment Corporation from approving any new financing (2) Prohibit procurement contracts with the country in issue. (3) raise the issue at the IMF (4) initiate in negotiations with respect to a bilateral or regional trade agreement[1]
Designation	South Korea (1988~1989) Taiwan (1988~1989, 1991~1992) China (1992~1994, 2019~2020) Vietnam, Switzerland (2020)	Vietnam, Switzerland (2020)

Source: 1988 Act, 2015 Act, Report

2-3. Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings

On February 4, 2020, the USDOC published a new CVD regulation, which allows countervailing measures to be imposed on the export goods subsidized from unfair undervalued exchange rates (Picone, 2020). The new CVD rule aims to cover an accusation of currency undervaluation through the domestic CVD investigation and measures (Lee, 2020).

The modified CVD rule amend its domestic regulation on CVD measures to allow the imposition of such remedies on exchange undervaluation practices adopted by foreign governments.[19] According to the language from 19 CFR 351, the new CVD rule fills that gap between the existing laws and a call for regulation for CVD proceeding against a foreign country's unfair currency practices. As mentioned above, there are three elements that the complaining party of the WTO dispute should prove three elements - financial contribution, benefit, and specific - in order to blame foreign countries' undervalued exchange rates as an illegal subsidy. However, the Tariff Act of 1930 and countervailing duty regulations before the new CVD rule did not provide specific languages to find the existence of 'Benefit' and 'Specificity' of the foreign countries undervalued exchange rates.[20] However, the new CVD rule provides the first legal basis for the DOC to proceed countervailing duties investigation against an unfair foreign exchange rate practice (Lee, 2021).

[19] See 19 CFR 351 "Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings. International Trade Administration."
[20] Ibid.,

The Department of commerce modified two regulations of the CVD procedures: benefit and specificity determination. First, the Department of Commerce's modification of 19 CFR 351.520 adds a new paragraph (c). This modification addresses the specificity of domestic subsidies. The new paragraph (c) provides that:

> "(c) Traded goods sector.
>
> In determining whether a subsidy is being provided to a "group" of enterprises or industries within the meaning of section 771(5A)(D) of the Act, the Secretary normally will consider enterprises that buy or sell goods internationally to comprise such a group."

According to the new paragraph (C), the Secretary of Commerce can determine "enterprises that buy or sell goods internationally" as a "group of enterprises" to meet the 'specificity' condition. Therefore, the specific statement of the "group" fills the loophole of the Tariff Act of 1930, section 771(5A)(D), which recognises the specificity of the subsidy only if it is provided to "a group of enterprises or industries". Even if the Tariff Act of 1930 fails to provide a definition of the word "group", § 351.502 Article (b) of the new rule sets out the definition of a "group":

> "(b) *Characteristics of a "group."* In determining whether a subsidy is being provided to a "group" of enterprises or industries within the meaning of section 751(5A)(D) of the Act, the Secretary is not required to determine whether there are shared characteristics among the enterprises or industries that are eligible for, or actually receive, a subsidy."

Therefore, the new rule further provides the Characteristics of a "Group", which allows the Department of Commerce to determine the existence of subsidy on a legal basis (Ikenson, 2020).

The second amendment is 19 CFR 351.528, which states more specified guidelines on determining the existence of 'benefit'. According to Lee (2021), the provision of 'benefit' sets out more detailed information than the provision of 'specificity' Paragraph (a)(1) of 19 CFR 351. 528 states that:

> "The Secretary normally will consider whether a benefit is conferred from the exchange of United States dollars for the currency of a country under review or investigation under a unified exchange rate system only if that country's currency is undervalued during the relevant period. In determining whether a country's currency is undervalued, the Secretary normally will take into account the gap between the country's real effective exchange rate (REER) and the real effective exchange rate that achieves an external balance over the medium term that reflects appropriate policies (equilibrium REER)"

This means that a decision on whether the currency is undervalued should be made in preference to the analysis of a "benefit". It further provides a definite method to determine the undervaluation of currency. Under Paragraph (a)(2)[21], the new rule states that "an affirmative finding" of currency manipulation can be drawn "only if there has been government action on the exchange rate that contributes to an undervaluation of the currency."

After the secretary of Commerce determines the undervaluation under paragraph (a), the next step for DOC is to find the existence of a benefit and calculate the

[21] Full text of § 351.528, (a)(2) provides that:

"Government action. The Secretary normally will make an affirmative finding under paragraph (a)(1) of this section only if there has been government action on the exchange rate that contributes to an undervaluation of the currency. In assessing whether there has been such government action, the Secretary will not normally include monetary and related credit policy of an independent central bank or monetary authority. The Secretary may also consider the government's degree of transparency regarding actions that could alter the exchange rate."

amount of benefit based on paragraph (b). Paragraph (b) of 19 CFR 351.528 provides that:

> "(1) *In general*. Where the Secretary has made an affirmative finding under paragraph (a)(1) of this section, the Secretary normally will determine the existence of a benefit after examining the difference between:
>
> (i) The nominal, bilateral United States dollar rate consistent with the equilibrium REER; and
>
> (ii) The actual nominal, bilateral United States dollar rate during the relevant time period, taking into account any information regarding the impact of government action on the exchange rate.
>
> (2) *Amount of benefit*. Where there is a difference under paragraph (b)(1) of this section, the amount of the benefit from a currency exchange normally will be based on the difference between the amount of currency the firm received in exchange for United States dollars and the amount of currency that firm would have received absent the difference referred to in paragraph (b)(1) of this section."

According to the language above, in order to prove the existence of a benefit, difference between (i) and (ii) should be examined first. After the existence of the benefit is confirmed, the amount of the benefit is calculated by deducting the amount of currency the exporter received to the amount of currency in the absence of the difference between (i) and (ii). In other words, the amount of benefit can be simply considered as the amount of the currency that the exporters receive due to the undervaluation.

IV. Currency Manipulation and Countervailing Duties under the WTO SCM agreement

This chapter examines the consistency of Commerce's new rule on countervailing duty regulations for currency undervaluation with the SCM Agreement. After the U.S. announced the proposal of modification of CVD rule, foreign government, issue related industries, and law firms have submitted comments on the proposal. The legal analysis here is based on the comments proposed and precedent study by trade experts.

1. Providing 'Financial contribution'

As mentioned earlier, in order for a measure to be interpreted as subsidy, it has to meet the definitions of "financial contribution" addressed in article 1.1 of the SCM Agreement. As mentioned above, however, the new CVD rule does not provide a specific definition for 'financial contribution'[22]. Instead of invoking a ruling, the DOC has noted that the determination of financial constitution is made on a case-by-case basis (Segal and Reinsch, 2020; Kim, 2021). Even though, the DOC finds that currency manipulation is in the nature of 'financial contribution', it is still difficult to prove the consistency under article 1.1 of the SCM Agreement. Here are two reasons elaborated.

First, currency undervaluation does not belong to any of the four categories stated in Article 1.1(a)(1) – "a government practice which involves direct transfer of funds",

[22] The proposed rule suggested receiving currency in exchange for U.S. dollars can be found to be a form of a financial contribution under section 771(5)(D) of the U.S. tariff Act. (Kim, 2021)

“government revenue that is otherwise due is foregone or not collected”, “goods or services” by government, or government’s “payment to funding mechanisms”. Moreover, currency manipulation does not fall under Annex 1 of the SCM Agreement which lists types of export subsidies.

Second, Commerce views financial contribution as an effect of currency undervaluation, arising when the US dollar is exchanged for the domestic currency. India proposed comments to the new rule saying that “this understanding is fundamentally flawed as it conflates the concept of financial contribution and benefit.”[23] The WTO panel found 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.”[24]

However, there are some cases where the undervaluation can be considered as a financial contribution. For example, According to Article 1.1(a)(1)(ii), the “goods or services” provided by the government can constitute a financial contribution.[25] So if the WTO considers the conversion of foreign currency by the Chinese government as a service or a direct transfer of money as china does not charge the exporter for a fee for

[23] See Comments on U.S. Commerce’s Proposal to Modify Regulations in Countervailing Duty Proceedings.
[24] WT/DS194/R, para 8.38.
[25] Article 1.1(a)(1)(ii) provides that

> “(iii) a government provides goods or services other than general infrastructure, or purchases goods;”

facilitating the exchange of the dollars for Chinese yuan (Pettis, 2011). In this case, currency undervaluation can be interpreted as financial contribution.[26]

2. Confirming *'Benefit'*

The new US rule treats the receipt of additional domestic currency in accordance with currency undervaluation as the "benefit". However, this treatment is considered to be inconsistent with the WTO agreement. Three arguments are discussed here. First, the US new rule suggests a methodology based on comparing a difference between the actual real effective exchange rate and its equilibrium REER. However, there is a problem with estimating an equilibrium REER as the results vary depending on different models (Kim,2021).[27] Since there is no agreed model, solely depending on a certain method to determine the extent of an undervaluation is improper. Therefore, using the result from a certain methodology is also inappropriate to measure a countervailable subsidy rate in the CVD proceeding.[28]

Second, the new rule disregards the interplay of the multitude of factors other than trade, such as labour productivity which can have an impact on the exchange rate. Catão (2007) from IMF argued that fiscal policies, financial development, and tariff can be used to explain the differences of REERs between countries. These fundamental should

[26] For more detailed analysis, See Kim, H. 2021. pp.9-11
[27] For detailed analysis, See Kim, H. 2021. pp.20-25.
[28] For more detailed analysis, See Lee, j. 2020. p.912-915.

be taken into account to estimate equilibrium REER. Therefore, the rule is very limited to fully determine the existence of benefit from currency undervaluation.

Lastly, The WTO Appellate Body of the *EC-Aircraft* case found that benefit analysis should examine both what is received and what is paid in turn as a result of an undervaluation.[29] However, the new rule only considers export increase and ignore any effects on import. Thus, the new CVD rule may fail to meet the 'benefit' condition in the WTO SCM Agreement.

3. Proving *'Specificity'*

Moving on to the specificity, the agreement states that a subsidy is "specific" when it is limited to "certain enterprises." WTO dispute cases also found the term "specific" to be limited to "certain enterprises". For example, the Appellate Body of the *U.S.-Upland case* interpreted "Certain enterprises" as "a limited group of producers of certain products"[30]. Therefore, "certain enterprise" refers to a particularized and known industry or group of industries that were grouped together by the kind of products they manufacture. However, the US new CVD rule defines the concept of "specific" in an overly broadway. The DOC defined "group" as enterprises that buy or sell internationally, therefore does not provide any specific criteria such as certain products and industries. Therefore, the new rule conflicts with WTO rules in terms of specificity as it fails to fulfil the criteria set under the WTO SCM Agreement.

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[29] WT/DS316/AB/R

[30] WT/DS267/R, Panel Report, *US – Upland Cotton*, paras. 7.1142 and 7.1151

In addition, the other conditions can be considered. For example, if currency undervaluation constitutes a prohibited subsidy, which is "contingent upon export performance", it is deemed specific under WTO rules. Some critics may say that currency manipulation can be a form of export subsidy as it lowers the price of exports while overprices imports, creating the effect of export and import-substitution subsidy. However, currency undervaluation is not listed in Annex 1 of the agreement which lists the illustrative list of export subsidies. In sum, countervailing currency undervaluation invoking the new CVD rule by the US commerce department is inconsistent with the WTO SCM Agreement.

V. Strategies to Counter Currency Manipulation

1. Multilateral/Plurilateral Approach

The discussion in chapter 3 uncovered the limitations of the two giant international organizations, IMF and WTO, in addressing the currency manipulation issue. Considering the persistent tension between the U.S. and China, the issue of currency manipulation is expected to continue. In this context, it is necessary to discuss about the need for alternative multilateral or plurilateral strategies. Thus, this chapter suggests three strategies in multilateral and plurilateral perspectives.

1-1. Improve Multilateral Agreement

Amend WTO SCM agreement

One of the simplest ways to amend the WTO SCM Agreement to address currency manipulation is to add currency manipulation to the list of prohibited subsidies. However, the prohibited subsidy is only exempted from the test of "specificity". Thus, two other hurdles – "financial contribution" and "benefit" remain to be proved. Furthermore, due to the WTO decision-making procedures, reaching an agreement among the member states is time-consuming. Especially with regard to the currency manipulation as a form of prohibited subsidy, there will be strong opposition from the

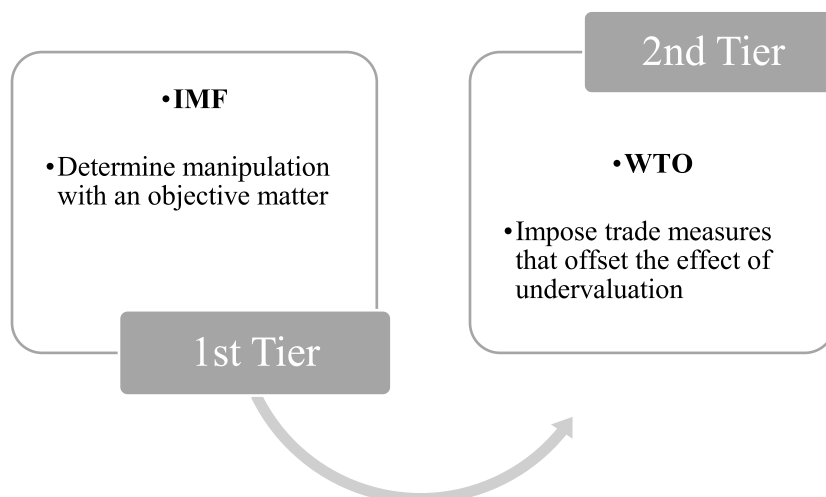
Non-market economies such as China and Vietnam. Korea is also not free from currency manipulation issues. Korea has been listed on the Monitoring list of the U.S. Treasury during the last 6 years (See *Table 2* above). This means that it is rarely possible to draw a consensus among the contracting members to amend the WTO SCM Agreement.

Improve WTO-IMF agreement

The WTO-IMF agreement mandates two organizations to cooperate in keeping their respective mandates and promote greater coherence in the international economic system (Hilbert, 2007). Even though both IMF and WTO address currency manipulation, neither of the agreement fully covers the issue of currency manipulation. However, the gap between the two institutions in approaching the issue of currency undervaluation works as a barrier to their cooperation.

In order to improve the WTO-IMF agreement, a “two-tier system” could be adopted to address the issue of currency manipulation. *Figure 4* illustrates the operation of the system. The first tier is for the IMF to determine the manipulation of currency through the objective methodology. The second step is for the WTO to impose trade measures that offset the negative effect of undervaluation based on the determination of currency manipulation by the IMF. In this sense, a proposed two-tier system under the WTO-IMF agreement can seek consistency in addressing the currency manipulation issue under the international agreement.

Figure 4: Two Tier System for IMF-WTO Cooperation



However, some limitations in operating the principle two-tier system might exist. First, as mentioned earlier, IMF's exchange rate assessment is based on two different methodologies, which are "Current Account (CA)" and the "Real Effective Exchange Rate(REER)" methodologies. This means that the assessment using these methodologies might result in conflicting estimations. To illustrate while one model found undervaluation, the other found no undervaluation. Therefore, the reliability and objectivity of IMF's assessment can be challenged.

Second, even if IMF produces an objective estimation of currency manipulation, the WTO has obscure rulings on which trade measure can be used and what are acceptable levels for that measure. Thus, in order to improve the WTO-IMF agreement in regard to currency manipulation, much more preparation and revision to both WTO and IMF agreements are needed.

1-2. *Enhance Plurilateral Trade Negotiation*

There is a growing emphasis on exchange rate issues in trade negotiations. Following this trend, the inclusion of a chapter on currency manipulation in plurilateral agreements could be one of the strategies to address the issue of currency manipulation. A chapter on currency manipulation in plurilateral agreements with like-minded countries could provide an exemplary model to address currency manipulation in trade negotiation. For example, USMCA first included a chapter on currency manipulation. It could be seen as a contradiction since the first-ever currency manipulation chapter was included in the agreements between countries which were never suspected as currency manipulators (Gantz, 2020). Since all the three-member countries deploy floating exchange rate systems, the currency chapter may not have a practical impact on contracting members. As mentioned above, however, the chapter will work as an exemplary model for future trade negotiations.

Likewise, the chapter on currency manipulation could be added to the CPTPP. Since the U.S. considers joining the CPTPP, this might be a chance to add a new chapter related to currency manipulation. Among the member states in the CPTPP, the majority of member countries adopt floating exchange rates, therefore they would welcome the new chapter to prevent currency manipulation. When it comes to countries like Vietnam, Malaysia, and Japan which are often listed in the monitoring list produced by the US treasury, an addition of the regulation in the plurilateral agreement will be preferable to unilateral measures(Bergsten and Schott, 2015). However, there are some concerns

regarding this plurilateral approach, which is whether sufficiently precise currency rules can be negotiated. If it is wrongly or imprecisely addressed, it would imperil member countries' ability to implement monetary stimulus (Johnson, 2015). Therefore negotiating and developing a well-designed currency chapter which does not impede monetary independence is the main issue here. Furthermore, a gradual approach from including the chapter in plurilateral agreements to including that chapter in multilateral agreements is also encouraged.

2. Bilateral/Unilateral approach

2-1. Establish Formal Bilateral Consultation Procedures

When it comes to the bilateral approach, the establishment of formal bilateral consultation procedures may prevent the escalation of the currency dispute into a legal dispute. In a circumstance where the legal binding for currency manipulation does not exist, there is a great possibility of abusing currency intervention in order to get a comparative advantage in the trade. Therefore, as a first step for the legal provision, it is suggested to establish formal consultation procedures through bilateral agreement or in the form of MOU. Complaining countries can negotiate on the issue first with countries suspected of being currency manipulators. Moreover, due to the complicated foreign exchange rate system, a formal channel between two countries is in need to share the standards and concerns relating to currency manipulation. This is a gentle action to

address the currency manipulation issue, comparing to the imposition of retaliatory measures, which escalate the situation into a legal dispute.

2-2. Countervailing Currency Intervention (CCI)

The last strategy 'Countervailing Currency Intervention (CCI) was suggested by Bergsten and Gagnon. CCI is a policy to sell domestic currency and buy currencies from those countries having been considered to be undervaluing their currencies for competitive advantage in the international market. This policy could be a superior alternative to countervailing duties for three reasons.

One of the advantages of CCI is the simple operation process compared to countervailing duties. First, in order to impose countervailing duties on the subsidized goods, there is a heavy burden of proof on the petitioning industries to demonstrate their injuries from the subsidized product (Bergsten and Gagnon, 2019). When it comes to CCI, however, if a country manipulates its own currency by purchasing US dollars to keep its currency undervalued, the US government could directly purchase back equal amounts of that country's currency without violation of the international rule (Bergsten and Gagnon, 2019). Secondly, it would not require the examination of the extent of currency manipulation, which is argued to be fluctuating depending on the methodology (Bergsten and Gagnon, 2019). Therefore this kind of unique procedure can be adopted as a fast track to counter currency manipulation issues without invoking legal dispute.

Another advantage of CCI is its effectiveness in dealing with the issue of currency manipulation. As the CCI simply neutralises the negative impact on the

exchange rate, it does not affect competitiveness and trade flows (Bergsten and Gagnon, 2019). In addition to that, the scope of its application is much broader as it covers not only a subsidized industry but also an entire economy. The CVD rule only covers exports from currency manipulating countries but overlooks the manipulator's imports and its trade with third countries (Bergsten and Gagnon, 2012). Lastly, the absence of bureaucratic problems emphasises the effectiveness of the CCI. This means that the new rule requires coordination between the Department of Commerce and the Treasury, which may induce bureaucratic problems (Segal and Reinsch, 2020). However, the operation of CCI will be solely managed under the Department of Treasury. Therefore, Treasury with the sole authority will be able to take more clear and prompt action toward the issue of currency manipulation.

The last advantage is the 'announcement effect' of the CCI. Bergsten and Gagnon argued that simply announcing the CCI policy would eliminate the incentive to manipulate its currency to some extent (Bergsten and Gagnon, 2019). Dealing with currency manipulation is much more complicated than other unfair trade practices as it expands their influence abroad. For instance, if country A manipulates its currency to get a comparative advantage in international trade, the neighbouring countries of A may experience disadvantages such as aggravated competitive position to country A. The adverse effect may encourage the neighbouring countries to intervene exchange rate market in order to prevent its currency from rising (Bergsten and Gagnon, 2012). However, if CCI policy is adopted or at least announced to be adopted, the neighbouring countries are able to use the initial weapon to counter currency manipulation at the first

stage by buying country A’s currency. Thus, the ‘announcement effect’ of CCI policy could prevent the spread of currency manipulation practices.

Despite the advantage of CCI, CCI is only a superior alternative to the new CVD rule but not a perfect alternative. There are possible limitations of the CCI instrument. First, in order to offset the manipulation, there should be enough assets to buy an equal amount of the manipulation country’s currency. Second, some non-market economies with closed financial markets may restrict the foreign purchase of their currency. Lastly, there is less inducement for countries to buy currency manipulating country’s currency because of the ruined credibility.

Nonetheless, a policy tool like CCI should be seriously measured against the new CVD rule. If a relevant international organization like IMF amends its article of Agreement to allow the operation of CCI, some of the limitations could be monitored under institutional supervision.

VI. Conclusion

The conflict between the U.S and China over currency manipulation has begun in earnest since the Trump administration. Before the Trump administration, expert groups and industries had expressed their complaints and opposition to China's undervalued RMB; however, the previous U.S. governments failed to gather momentum to specifically address the sensitive issue. Since there is a globally shared understanding that the exchange rate policy lies under each country's autonomy. Even though there were some movements to address the issue in the international sphere through the IMF and WTO, these international rules were not a perfect fit for the issue. This is because the classificatiton of the currency issues was very much vague so both IMF and WTO fail to fully address the issue.

In this context, Trump was the first U.S. president who took the lead in the effort to address the currency manipulation issue. His eagerness to address the currency issue was proved with the publication of the new CVD rules adopted by USDOC. This new rule not only attracted domestic interest but also global interest; because it was the first CVD rule enacted to respond to the currency issue. Even though it was often argued that currency undervaluation can be a form of subsidy by giving a comparative advantage to the exporters, the new CVD rule was the first trial to address currency undervaluation as a subsidy and to offset unfair disadvantage through countervailing duties. However, the consistency of the new CVD rule with the WTO SCM Agreement is the remaining legal

issue. Based on the previous research and WTO dispute cases, this paper conducted the legal analysis and found that it is difficult to conclude currency undervaluation constitutes a countervailable subsidy under the current WTO rules.

Despite the challenge, the currency undervaluation issue seems to continue as President Biden maintains Trump's approach toward China. Recently, On May 5, the Commerce Department has announced a final determination in a countervailing duty case over Vietnamese tire imports. It remains to be seen whether the U.S implement the ruling or not, and China's opposition and retaliation; however, this unilateral approach clearly raises the need for developing more predictable measures. In other words, other alternative strategies to counter currency undervaluation in both multilateral and bilateral perspectives need to be discussed and developed. This paper suggested several possible strategies but one perfect overarching approach does not exist. This leads to the essence of this paper: all relevant approaches should be actively gathered in order to discuss the issue of currency manipulation and complement the limitation of each strategy.

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국문초록

미・중 무역전쟁의 새로운 전선, 환율 보조금:
WTO 보조금 협정과의 합치성 분석을 중점으로

박 수 령

1980 년대부터 심화되어온 미-중간의 무역적자 문제는 2008 년 글로벌 금융위기 이후 미국의 對중국 경상수지 적자확대와 중국의 연평균 9%의 경제 성장이 대조되며, 이러한 경제상황 불균형의 주범으로 중국의 환율 문제가 대두되었다. 그간 미국은 다자간 및 양자간 채널을 통해 중국의 환율 문제를 다루고자 했으나, 기존 IMF 및 WTO 역할의 한계 및 양국의 미온적인 태도로 인해 큰 성과를 내지 못한 채 계류했었다. 2017 년 집권한 트럼프 대통령은 그전의 행정부와 달리 중국의 환율조작 문제를 강하게 규탄하며, 미국의 강경한 대응을 예고했다. 트럼프 대통령은 2019 년 25 년만에 처음 중국을 환율조작국으로 지정하였으며, 이로 인해 중국의 통화 저평가 문제는 미국 의회에서 상당히 중요한 정치적 이슈로 자리잡았다. 그간 미국은 해외국의 인위적인 통화절하 행위에 대응하기 위한 국내적 조치로써 환율조작행위를 보조금으로 간주하여 상계관세를 부과하는 방안을 논의해왔다. 이와 같은 노력의 일환으로 미국 상무부는 지난 2020 년 2 월 구체적인 상계관세 규정개정안을 도입하여, 상계관세 부과 기준인 정부 및 공공기관의 '재정적 기여'와 '특정성'의 판단 기준을 상당히 완화한 바 있다. 해당 개정규칙을 기반으로 미국은 베트남산 타이어 및 중국산 트위스트 타이 상계관세 조사를 실시하였으며, 지난 2020 년 11 월 예비판정에서 외국의 통화 저평가 행위를 상계할 수 있는 보조금으로 판정한바 있다.

환율 저평가 행위가 WTO 의 보조금 및 상계관세 협상상 보조금에 해당하는 지의 여부가 계속해서 논쟁이 되어온 가운데, 미국 상무부의 상계관세 개정규칙을 통한

환율관세부과는 세계무역기구(WTO)의 보조금 및 상계조치 협정(ASCM)과의 상충 소지가 있어, 이와 관련한 법적분쟁이 예상된다. 따라서 본 논문은 미국 의회와 행정부의 중국의 환율조작 행위에 대한 공격적인 대응상황을 검토하는 동시에 WTO 의 ASCM 에 기반하여 저평가 위안화에 상계관세를 부과하기 위한 제정된 연방규정 개정안에 대한 법적인 분석을 수행하는 것을 목적으로 한다. 또한 IMF 및 WTO 등 국제기구의 환율조작대응에 대한 근거 규정 부재로 인한 다자체제의 약점개선을 위해 다자간 그리고 양자간 채널을 통한 대응전략을 논의한다.

주제어: 미중무역전쟁, 환율조작, 환율보조금, WTO, ASCM

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