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The WTO-Consistency Issues of Countervailing Currency Undervaluation

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The US Department of Commerce (USDOC) adopted a new rule to impose a countervailing duty (CVD) on imports from countries undervaluing their currencies, arguing that an artificially weak exchange rate amounts to an export subsidy. This ruling, however, raises a variety of systemic and legal problems of whether it is possible to regulate exchange rates under the multilateral trading system. In fact, it raises a fundamental issue about coherent governance on international economic systems to bridge between financial and trade institutions. In addition, it questions whether it is possible to consider currency undervaluation as a countervailable subsidy under the Agreement on Subsidies and Countervailing Measures (ASCM). This paper highlights the structural limitations of regulatory evolution in the WTO and IMF. In addition, this analysis shows that the manner the CVD was applied causes many legal problems in terms of WTO consistency. Considering huge potential implications of currency-based CVDs, it is imperative for the WTO Members to agree on proper guidelines that discipline overly excessive use of trade remedy measures.

Keywords Currency manipulation, Countervailing duty, Currency subsidy, Subsidy Agreement, IMF, WTO

INTRODUCTION

On 4 February 2020, the United States Department of Commerce (USDOC) issued a final rule that established a process by which it can impose tariffs against foreign companies from countries whose governments take action to undervalue their currency (USDOC, 2020). This final rule provides a legal basis for the USDOC to regard currency undervaluation as an unfair export subsidy under the United States countervailing duty

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(CVD) law, and allows the use of import tariffs to offset this effect. As soon as this rule entered into force, the USDOC determined for the first time that undervaluation of Vietnam's currency is a countervailable subsidy (USDOC, 2021).

In fact, the controversy over exchange rate policies has a long history. For example, the decision to investigate currency as an export subsidy had sparked a serious concern in the US Congress during the Bush Administration (Irwin, 2017). The US policymakers have contemplated for a long-time various action plans to deal with China's intervention in exchange market (Mattoo and Subramanian, 2009; Staiger and Sykes, 2010). They alleged that China has regularly intervened in international exchange markets to prevent renminbi from appreciating relative to other currencies and thus has incurred large global imbalances. Numerous public officials and commentators proposed both multilateral and unilateral actions against allegedly China's 'currency manipulation'. These proposals include the possibility of referring the matter to the International Monetary Fund (IMF) by the Treasury Department, bringing a formal complainant to the World Trade Organization (WTO) dispute settlement by the USTR, or treating China's 'currency manipulation' as a form of countervailable subsidies and impose CVDs on Chinese imports that materially injured competing US industries by the USDOC.

However, the USDOC maintained a position that currency undervaluation is not actionable as a subsidy under the US law. The USDOC declined to investigate China's currency subsidy allegation because the petitioner's allegations did not meet legal requirements to initiate an investigation. They reasoned that Chinese currency subsidies are available to all parties, not specifically to exporters and thus the subsidy is not 'specific' as required under both US and WTO laws. Despite its long-standing position, the USDOC has recently reversed its approach and modified regulatory procedures of CVD proceedings to treat currency undervaluation as countervailable subsidies.

The currency issue regained prominent attention because of the growing tensions between China and the United States. Moreover, a confluence of other factors, including Russia's invasion of Ukraine, China's provocation against Taiwan, the prolonged pandemic situation and dramatically changing monetary policies of major developed countries, are creating much greater exchange rate volatility in the recent months (Clague, 2022). Thus, the current shift in the position of the US administration requires a careful assessment of a close relationship between exchange rate policy and trade policy. In fact, this issue raises economically both theoretical and empirical question of whether it is possible calculate the existence and the amount of 'currency undervaluation' and impose a duties on individual companies. More importantly, it raises legal disputes over whether it impairs any obligations in international trade agreement. Furthermore, this issue raises a fundamental legal question of a linkage between the IMF and WTO regarding exchange rate matters, and whether a CVD is an appropriate response to exchange rate policies that may impair market access commitments under the WTO agreements.

This analysis focuses on legal aspects of countervailing alleged 'currency manipulation'. Section II examines the international rules on currency manipulation in IMF and the WTO. Section III analyzes the USDOC's first determination of currency undervaluation towards Vietnam. Section IV argues that the USDOC's new rule to introduce currency CVDs may not satisfy the WTO obligations from a legal standpoint. Section V concludes.

REGULATORY DEVELOPMENTS CONCERNING EXCHANGE MATTERS IN INTERNATIONAL ECONOMIC ORDER

Article IV of the IMF

At the end of the Second World War, there was a generalized conviction that new international economic order should be established in order to maintain peace and security in the world (Eichengreen, 2019). In doing so, priority was given to monetary over trade concerns (Gardner, 1996). Monetary stability was considered a precondition for any economic commitments. Otherwise, monetary policies and competitive exchange manipulation would be able to artificially distort competitive market conditions.

The IMF established a general framework on international regulation of exchange rates so as to maintain stability of the fixed parity exchange rate system between 1946 and 1971. The original language of Article IV of the Articles of Agreement of the IMF stated that "a member shall not propose a change in a par value of its currency except to correct fundamental disequilibrium." Thus, the IMF members could not change their exchange rates from the level recognized by the IMF without its consent, except to correct 'fundamental disequilibrium,' although the meaning of 'fundamental disequilibrium' was left undefined.

However, Article IV was significantly revised in the wake of the collapse of the Bretton Woods system (Gold, 1983). The executive board recognized that members have monetary sovereignty over their exchange rate policies, but they restricted members from manipulating exchange rates with the intent of 'preventing effective balance of payments' or 'to gain unfair competitive advantage over other members.' The executive board decision on 'Surveillance over Exchange Rate Policies' adopted in 1977 also laid out principles of guidance for member's exchange rate policies. Based on this decision, the IMF can prohibit members from intervening in exchange markets only if the intent of the manipulation is clearly established, the member may be found to be in violation of the Article IV.

While the negotiations for the establishment of the International Trade Organization (ITO) were discussed separately after the Bretton Woods conference, there was an understanding that reduction of trade barriers and harmonization of commercial policies were necessary conditions for international monetary stability. The US State Department published the 'Proposals for Expansion of World Trade and Employment' containing the US' vision for the world trading system. After some modifications, the 'Final Act of the United Nations Conference on Trade and Employment: Havana Charter for an ITO' was agreed so as to bring the ITO into being.

Along with the IMF Articles of Agreement, the 'Havana Charter for an ITO' contained numerous detailed articles on the matter of balance of payments, exchange rates, and quantitative restrictions so as to complement to work of the IMF. Article 4 of the Havana Charter titled the 'Removal of Maladjustments in the Balance of Payments' contained an obligation for members to take full responsibility in correcting any maladjustments in balance of payments position. Article 21 on 'Restrictions to Safeguard the Balance of Payments' recognized that members have the primary responsibility

to safeguard the balance payments position and allowed members to restrict import if necessary. Article 6 also allowed a member suffering from external inflationary or deflationary pressure to take actions to safeguard their economies.

More detailed and comprehensive articles governing the matters of quantitative restrictions, balance of payments, and exchange matters were included in Chapter IV of Commercial Policy. Section B on 'Quantitative Restrictions and Related Exchange Matters' contained five articles related to members' financial policies that could potentially lead to trade effects. In particular, Article 24 paragraph 4 recognized that members' trade action could affect the IMF Articles and exchange actions could affect the ITO Charter. Paragraph 4 provided that members shall not by exchange action frustrate the intent of the ITO Charter, and by trade action frustrates the intent of the IMF Articles. Paragraph 1 of the same article mandated that the ITO and IMF shall pursue a coordinated policy recognizing that exchange rate policy and trade policy are closely intertwined. In addition, if the ITO is to resolve disputes concerning matters of monetary reserves, balance of payments or foreign exchange arrangements, paragraph 2 stipulated that the ITO shall consult with the IMF. The ITO gave deference to the IMF for the determination as to whether the member's exchange action is in accordance with the IMF's Articles of Agreement, as well as for the judgement of whether it is appropriate to invoke a balance of payments exception.

Although detailed rules on how to coordinate exchange matters were prepared, the ITO never came into existence. The US failed to ratify the ITO Charter because of domestic political pressures (Diebold, 1952; Ahn, 2000). Instead, the General Agreement on Tariffs and Trade (GATT) entered into effect as the 'Protocol of Provisional Application' on 1 January 1948. The general clauses of the GATT were similar to the chapters of the ITO Charter. However, negotiators excluded several important chapters, especially concerning how to regulate exchange matters. The ambiguous legal status of the GATT created systematic problems complicating efforts to coordinate with the IMF when it comes to addressing the issues of monetary reserves, exchange rates, and balance of payments.

Article XV of the GATT

Article XV titled 'Exchange Arrangements' governs exchange rate matters in the GATT treaty. Paragraph 1 stipulates that the contracting parties seek cooperation with the IMF and pursue a coordinated policy with regard to exchange questions. In addition, paragraph 2 provides that if the contracting parties are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they are mandated to "consult fully with the IMF" and in such consultation, the contracting parties have to "accept all findings of statistical and other facts presented by the fund" as well as their determination "as to whether action by a contracting party in exchange matter is in according with the Article of Agreement of the IMF". All these paragraphs give a huge deference to the IMF when it comes to exchange matters.

In addition, paragraph 4 contains an obligation not to use exchange actions or trade actions that frustrate the intent of the GATT treaty and the IMF Articles. Also,

paragraph 9(a) provides that GATT does not preclude the use of 'exchange controls' or 'exchange restrictions' that are consistent with the IMF's rules (Siegel, 2002). Similarly, paragraph 1 of *Ad* Article VIII of the GATT provides that with the approval from the IMF, the use of multiple currency exchange fees for balance of payments reasons does not constitute a violation of the GATT obligations.

However, the role of the IMF is not clear if parties enter into a dispute. Suppose a country restricts imports arguing that such action is necessary in order to safeguard its external financial position and its balance of payments, the exporting partner may challenge the importing country arguing that such action is inconsistent with Article XII of GATT or Article XI of GATS. Then, the panel and Appellate body have to determine whether the importing country's external financial position is in balance. To do so, the panel and Appellate body may render its judgement to the IMF. However, it is not clear to what extent should they accept the IMF's analysis results.

Another legally questionable issue is currency manipulation. Note 2 to 'paragraph 2 and 3' of GATT *Ad* Article VI states that:

> "Multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 or can constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action under paragraph 2. By "multiple currency practices" is meant practices by governments or sanctioned by governments."

Under the par value system, the GATT basically required that conversion of exchange rates be based on the recognized exchange rate of the IMF or a special exchange arrangement, if not a member of the IMF but a contracting party to the GATT (Jackson, 1969). The interpretative note 1 *Ad* Section B of Article XVI, which was added at the Review Session in 1954-1955, notes that "nothing in Section B shall preclude the use by a contracting party of multiple rates of exchange in accordance with the Articles of Agreement of the IMF." During the GATT era, the panel on subsidies and state trading interpreted that this provision was intended not to preclude the use of multiple exchange rates if they were approved by the IMF, but "there is a clear obligation to notify to the contracting parties the multiple exchange rates which have the effect of a subsidy (GATT, 1960)."

In principle, multiple currency practices and currency retention schemes can be subject to CVD (Siegel, 2002). Since CVDs are intended to punish a member from using unfair trade practices such as subsidies and put pressure on such member to remove the measure in question, it makes sense to offset any distortive effect of exchange rates if it constitutes a form of subsidy. In practice, however, the problem of applying duty based on this language was not pronounced because the IMF encouraged members to eliminate multiple exchange rates. Gradually as multiple currency practices disappeared, this article became meaningless.

Trade and Finance Linkage in the WTO System

During the Uruguay Round, both the IMF and the WTO strived to establish a rule for

cooperation between the two institutions considering that trade, balance of payments and exchange rate policies are all intertwined.

The Marrakesh Declaration of April 15, 1994 provided that one of the negotiating objectives of the WTO is "to achieve greater coherence in global economic policy-making through strengthening its relationship with other international organizations for monetary and financial matters (GATT, 1986)." The 'Functioning of the GATT System (FOGS)' negotiating group was established in order to establish statutory linkages and cooperation between these institutions, but no formal agreement entered into force.

Article III:5 of the 'Agreement Establishing the World Trade Organization' states that "with a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the IMF and with the International Bank for Reconstruction and Development and its affiliated agencies." This mandate is re-emphasized and elaborated in paragraph 5 of the Declaration of the World Trade Organization to Achieving Greater Coherence in Economic Policy Making (so-called 'Coherence Declaration'), which states that the WTO should "pursue and develop cooperation with the international organizations responsible for monetary and financial matters." This is to be done while respecting the mandate and necessary autonomy of each organization, and more importantly, while avoiding the imposition of cross-conditionality or additional conditions on member states.

Paragraph 8 of the 'WTO Agreements with the IMF and the World Bank' adopted by the General Council in November 1996, provides that they would communicate with each other about matters of mutual interest. The WTO dispute settlement panels are specifically excluded from the obligations to communicate, but paragraph 8 further states that the IMF shall inform the WTO, including its dispute settlement panels, when the WTO is "considering exchange measures within the Fund's jurisdiction (WTO, 1996)." Paragraphs 3 and 4 state that the IMF has agreed to inform the WTO about any decisions it had made approving any restriction a country might impose on international payments, discriminatory currency practices, or other measures aimed at preventing a larger or sustained outflow of capital. The IMF also agreed to participate in consultations held by the WTO Committee on Balance of Payments Restrictions regarding any discussion on measures taken by members to safeguard its balance of payments.

In spite of these efforts, the *legal* relationship between the IMF and the WTO is still left undefined (Ahn, 2000). The 'Declaration on the Relationship of the WTO with the IMF', which is included in the final act of the Uruguay Round confirmed that "unless otherwise provided for in the Final Act, the relationship of the WTO with the IMF, with regard to the areas covered by the Multilateral Trade Agreements in Annex 1A of the WTO Agreement, will be based on the provisions that have governed the relationship of the CONTRACTING PARTIES to the GATT 1947 with the International Monetary Fund."

In recent years, the USDOC modified its CVD rule to impose a duty towards a country undervaluing its currency arguing that artificially weak currency amounts to an illegal export subsidy. However, if a Member brings a case to the WTO, the panel and Appellate body must determine whether an importing country's imposition of a CVD based on currency undervaluation allegation is legally justifiable under the

WTO Agreement. This issue is complicated because it concerns whether the USDOC's investigation on the existence of currency undervaluation is reasonable, and whether the calculation of the amount of benefit accrued as a result of an undervaluation is legally legitimate. Since this issue is technical and requires expertise in economics and finance, the WTO dispute settlement body could seek support from the IMF. However, there is no legally binding obligation for the IMF to respond. Furthermore, even if the IMF analyzes whether the USDOC properly calculated the extent of undervaluation, it is in no position to determine whether the USDOC properly interpreted the results into a tariff rate. Also, it is even more problematic if the IMF determines that currency undervaluation did not exist or even overvalued. How to coordinate this process and to what extent should the panel and Appellate body defer judgement to the IMF are ambiguous under the existing WTO rules, and if these issues are raised in the WTO case, it could serious challenge the already fragile WTO system.

CURRENCY UNDERVALUATION AS A COUNTERVAILABLE SUBSIDY

The USDOC's Modification of CVD Rules on Currency Undervaluation

The USDOC determined for many years to preclude the use of CVDs against imported products from Non-market Economy (NME) (Ahn and Lee, 2011). In 2007, however, the USDOC has completely reversed this position, and decided to apply a CVD in the case concerning *Coated Free Sheet Paper from China* (USDOC, 2007). In this case, the petitioners also requested the USDOC to investigate whether alleged undervaluation of China's currency is a countervailable subsidy (USDOC, 2010). However, despite the petitioners' claims, the USDOC maintained a position not to investigate this issue arguing that the allegations do not meet the statutory requirement for initiating an investigation because the benefits provided under China's unified foreign exchange regime are not specific to the enterprises or industries (Inside US Trade, 2010).

On May 28, 2019, the USDOC modified its position and proposed an amendment to its existing definitions of 'specificity' and 'benefits' (USDOC, 2019). The USDOC published a final rule establishing a process of applying a CVD on imported products from a country whose government intentionally undervalued their currency (USDOC, 2020).

Under the final rule, the USDOC can impose CVDs by calculating the benefits conferred when it determines that currency undervaluation has occurred due to government intervention. The final rule provides that the USDOC will 'normally' estimate currency undervaluation by taking into account the gap between the country's real effective exchange rate (REER) and the REER that achieves an external balance over the medium term that reflects appropriate policies or otherwise known as the equilibrium REER. The new rule explicitly provides that USDOC will only make an affirmative finding if there has been 'government action on the exchange rate' and that such government action "will not normally include monetary and related credit policy of an independent central bank or monetary authority."

In assessing currency undervaluation by government intervention, the final rule provides that the USDOC can refer to the Treasury Department's evaluation and conclusion. However, the USDOC clarified that the Treasury's analysis is distinct from the analysis. This implies that USDOC's decision to conduct a CVD investigation and apply duties thereby is separate from the Treasury's designation of a currency manipulator.

The Case of Passenger Vehicle and Light Trucks tires from Vietnam

After the final rule is published, on May 27, 2021, the USDOC determined for the first time that Vietnamese Dong was undervalued, and that this undervaluation constituted a countervailable subsidy under the US CVD law (USDOC, 2021). This case established a precedent in several important areas and is likely to be used as a template for future USDOC's decisions in its CVD investigation. Since the USDOC determined that Vietnam's currency is undervalued and, the US petitioners can raise this claim in future CVD investigation towards imports from Vietnam.

Under both the U.S. and the WTO law, a government program is deemed to be a countervailable subsidy when it meets three criteria. The program must (i) constitute a financial contribution provided by a government authority or public body, (ii) yield a benefit to the recipient, and (iii) be specific to an enterprise or industry or a group thereof.

The rulings from this case are important in many aspects. First, in determining whether currency undervaluation was "specific" for purposes of its preliminary determination, the USDOC relied on the USD inflows into Vietnam as a proxy for conversion of USD into VND. The USDOC analyzed inflows of USD via exports of goods, exports of services, various forms of portfolio and direct investment, and earned income from abroad. In the USDOC's preliminary investigation, it found that the traded goods sector accounted for 71.94 percent of USD inflows, and thus found that the subsidy was *de facto* specific to this group. In the final determination, this preliminary finding of specificity was challenged because the traded goods sector is too broad to constitute a "specific" group of enterprises. Since the members of the traded goods sector came from various industries, the subsidy would be spread throughout the entire economy, not specific to one sector. In addition, entities that buy or sell goods internationally were not "known or particularized" as is required by WTO case law (WTO, 2014). However, the USDOC rejected both arguments stating that there is no specific requirement to comprise a "group" and that a particular portion of USD inflow went to the traded goods sector is adequate evidence of finding "known or particularized" group.

Second, the USDOC used the results of an analysis published by the U.S. Treasury to determine the existence of currency undervaluation in Vietnam and the level of CVD levied on individual companies. The USDOC completely relied on the Treasury assessment, and calculated that VND had been undervalued against dollar by 4.7% in 2019. To make this decision, the USDOC relied on the Treasury's Global Exchange Rate Assessment Framework that is based on a current account model developed by the IMF. Although the much of the framework relies on the current account model used by

the IMF, the underlying data and economic assumption used in the assessment of the VND were not clear and disclosed publicly during the investigation. The respondents argued that USDOC should have disclosed not only the model used by Treasury but also the underlying data and should have put that information on the administrative record. However, the USDOC responded that disclosure of all the Treasury data was not required by the subsidy regulations.

Third, after it had been confirmed by the Treasury that VND was undervalued during the relevant period, the USDOC determined that the amount of benefits provided to each mandatory respondent in the CVD proceedings. To do so, the USDOC deducted 4.7 percent of undervaluation estimated by the Treasury to each currency exchange transaction reported by mandatory respondents, and aggregated the sum of these individual transactions. Then, a countervailable subsidy rate for each respondent was calculated by dividing the aggregated sum of individual transactions minus the estimated devaluation rate by the total sales conducted in dollars during the period of investigation (USDOC, 2020).[1]

In this case, the respondents raised serious questions about the specific methodology used by Treasury that USDOC relied on to determine undervaluation. It argued that other models of estimation such as those used by the IMF, which is the basis of the Treasury's own methodology produced different results, including that the VND was overvalued. The USDOC, however, responded that those models concerned periods before 2019, and were thus not relevant. Also, since USDOC did not explain clearly why it relied on one specific model to make its undervaluation determination, and why the underlying data, such as the 'safe asset index' and the 'commodity terms of trade gap' are critical for the assessment, it could raise serious legal questions. Another issue is that the Treasury model relies upon the concept of 'desired policies,' such as the ideal amount of exchange intervention. Deviation from the 'desired policy' can be a reason for undervaluation in the model, but the data on the administrative record do not reveal at what level Treasury set these desired policies in its model.

It is understandable that USDOC's methodology is still under development. However, as noted above, in this case, USDOC disregarded alternative valuation methodologies proposed by the parties on the grounds that it is irrelevant to the period of investigation. If the parties provide contemporaneous alternatives, it must decide which analysis to adopt and explain why it relied on that specific model for the analysis, which could be challenged in various economic grounds.

WTO CONSISTENCY ISSUES

Financial Contribution

In addition, the *Passenger Vehicle and Light Truck from Vietnam* case raised serious legal questions of the WTO case law. The essential legal criteria to invoke a CVD is that

[1] On this basis, the USDOC preliminarily determined the CVD rate of 1.69 percent *ad valorem* for Kumho Tires Vietnam, and 1.16 percent *ad valorem* for Sailun.

a member imposing the duty must demonstrate that a foreign government's exchange rate policy is a 'subsidy' under Article 1 of the ASCM, and such subsidy has been passed through to the product subject to the CVD investigation. Both footnote 36 of the ASCM and GATT Article VI:3 provide that a CVD must be imposed on a specific product for the purpose of 'offsetting any subsidy'. The panels and the Appellate body confirmed that a member imposing a CVD must demonstrate that the subsidy has been passed through to the manufacturer, producer, and exporter of the subject merchandise (WTO, 2004).

The USDOC's final rule on countervailing undervaluation does not directly addresses financial contribution. The USDOC stated that determination on this matter will be made on a case-by-case basis. Since it is not specified in the rule, it is very difficult to raise a claim in the litigation. However, in the proposed rule, the USDOC explained that "the receipt of domestic currency from an authority (or an entity entrusted or directed by an authority) in exchange for US dollars could constitute financial contribution under section 771(5)(D) of the Act (USDOC, 2019)." Also, the USDOC responses to various comments on the final rule explained that if the exporting enterprises receive more domestic currency in exchange for each US dollar converted than they would otherwise earn in the absence of the currency undervaluation, it could be 'direct transfer of funds' under the US CVD law. Therefore, if a country wishes to file a case in the WTO dispute settlement or in the CIT, it must establish that the USDOC failed to sufficiently demonstrate the financial contribution requirement in actual CVD proceedings.

In general, the USDOC can claim that a financial contribution has occurred through state banks by overpaying exporters in the form of cash at an undervalued rate. The investigating authority has an evidentiary requirement to prove that a foreign country's state-controlled banks are either a 'public body' or 'entrusted or directed' by the government to provide various financial contributions. There is no clear definition of these terms in the agreement. The panel seems to hold the view that when deciding if a body is public, ownership should be decisive criterion although this factor *per se* is not perfect substitute for control (WTO, 2005a; 2005b). The Appellate body, however, held that a 'public body' in the sense of Article 1.1 ASCM should be determined by whether the entity 'possessed, exercised or vested with government authority', not merely based on ownership structure. This Appellate body decision led to a huge controversy in the WTO dispute settlement and the panel practically modified the Appellate body rulings allowing the investigating authority to find 'meaningful control' by government instead of exercise of governmental authority in *US – Countervailing Measure (China)(Article 21.5 – China*). However, in this case, the Appellate body again ruled in favor of the approach that it had followed in the its report on *US – Antidumping and Countervailing Duties* (China) that for an entity to be acknowledged as a public body it must exercise government control, not just possessing the possibility of it.

Based on this interpretation, the investigating authority has to show that a foreign government has authority in all aspects of the entity's operations based on statements and evidence included in the USDOC CVD questionnaires. The country affected by CVDs could counter-argue that a bank engaged in currency exchange is not under government authority because there is no 'exercise of government control' although the government has a majority of ownership.

The greater hurdle is posed by the requirement to satisfy Article 1.1 of the ASCM. It lists different types of 'financial contribution' – direct transfer of funds by governments, a government revenue foregone or not collected, government provision of goods or services, or government entrusted or government payments to a funding mechanism to carry out one of these three functions.[2] The panels and the Appellate body also confirmed that this list is exhaustive and that government practices that are not among the enumerated items are not subsidies even if they provide an economic benefit to a recipient (WTO, 2001; WTO, 2005c).

In the investigation against Vietnam, the petitioners argued that Vietnam's exchange rate regime provides a financial contribution to Vietnamese exporters through the exchange of currency at an undervalued rate (WTO, 2001; WTO, 2005). In the case of Vietnam's exchange rate policy, its foreign exchange transactions including export receipts were required to be settled through the Vietnamese state bank. The USDOC determined that the financial contribution by government had occurred by overpaying exporters through the exchange of currency at an undervalued rate. In *US – Carbon Steel (India)*, the AB held that a government practice involving 'direct' transfer of funds can even occur through 'any intermediaries' (WTO, 2014). Based on this interpretation, it is arguable that there is a direct transfer of fund if exporters exchange their currency at an undervalued rate (Staiger and Sykes, 2010).

An alternative argument for the existence of a 'financial contribution' can be that the government has foregone revenue by currency intervention. To find whether there is 'government revenue foregone', the AB in *US-FSC (Article 21.5-EC)* has held that a normative benchmark should be identified and apply a 'but for' test to examine the tariff revenue absent the contested measure (WTO, 2000). In the short run, imports may become more expensive so that consumers buy fewer of imports than it would normally buy, if it had not been for currency intervention. However, flexible prices negate any real decline in revenue in the long run (Staiger and Sykes, 2010). Since net tariff revenue depends on the elasticity of import demand, an argument that undervaluation had caused decrease in net tariff revenue can be economically challengeable.

Benefit

Even if a 'financial contribution' could be found, it is essential that undervaluation confer a 'benefit' to the recipient. The USDOC's final rules established a methodology to calculate the amount of benefits conferred on exporters as a result of a currency undervaluation. The USDOC explained that it will 'normally' use this methodology. This term implies that the USDOC has discretion to apply other alternative methodologies and evidence if it is deemed appropriate. In response to public comments, the USDOC also held the possibility to expand and develop detailed criteria of calculating the amount of benefits in future as it gains more experience. Therefore, the USDOC has broad discretion to apply other alternative methodologies of calculating a benefit.

This method for calculating the amount of benefits bestowed raises both conceptual

[2] A subsidy may instead result from an 'income or price support'. This term, however, has not been interpreted in the WTO dispute settlement.

and practical problems. When the producers invoice their products in home currency or in dollars, if the government intentionally depreciates their currency, the price of imports may become more expensive so that consumers may buy less. But if producers invoice their products in the currency of consumers, there is no expenditure-switching effect. Also, in the long run, devaluation has an effect of both import tariffs and export subsidy, and therefore, it has no real effect on relative prices and thus no benefits to the exporters.

In addition, the IMF's external balance approach for estimating currency undervaluation is not established as a proper benchmark. The theoretical and empirical literatures have not reached a consensus on the key determinants of the current account model. Also, there are other alternative methodologies for calculating the extent of an undervaluation even within the current account methodology used by the IMF, and the results these models tend to yield conflicting results. Considering that there are many other options for measuring equilibrium REER, it is inappropriate to solely rely on a single method to determine the extent of an undervaluation and use the result to measure a countervailable subsidy rate in the CVD proceedings. And this methodology is even more problematic, as the methodologies used to discern currency undervaluation in one country yield different results.

Furthermore, the USDOC's method of calculating 'benefits' by aggregating the sum of dollar earnings converted into domestic currencies in a bank during the period of investigation ignores any real effect of subsidy on export and import sales of a producer. In accordance with the WTO ASCM, the benefit analysis should capture the total effect of what a recipient has received as a result of a government subsidy program (WTO, 2011a). However, the new USDOC's rule ignores any effects on imports by focusing only on the export increase of a firm as a result of an undervaluation (Lee, 2020).

However, even if the USDOC's new rule considers only the export-side of the benefit analysis, its methodology of calculating a countervailable subsidy rate partially accounts for increase in export sales of a producer as a result of a government undervaluation. Suppose consumers in the US responded to increase in the price of domestically produced good *u* relative to the price of good *c* as a result of an undervaluation in a country producing good *c,* the producer of good *c* will enjoy increased export sales of good *c* in the US. However, if the producer of good *c* increased export sales as a result of a government's currency undervaluation, the USDOC can determine that an export subsidy exists and calculate a CVD to offset the subsidy. Conceptually, the amount of export subsidy should be equivalent to the net export sales of a producer as a result of an undervaluation. However, the USDOC's method of calculating a subsidy rate does not account for any changes in export sales of a producer and calculates only the dollar earnings converted into domestic currencies in a bank minus the extent of an undervaluation during the period of investigation. Thus, the USDOC's methodology insufficiently captures the total export promotion effect of a subsidy.

Lastly, at the micro-level, producers as rational actors can choose when and how to realize the dollar earnings into domestic currencies in order to increase their revenue. For example, if a producer increased export sales as a result of an undervaluation in domestic currency, it is more advantageous to converts the dollar earning into domestic

currency when the value of domestic currency appreciates. A producer's rational decision to hedge exchange rate volatility creates a time lag for the producer to convert its dollar earnings into domestic currency. Also, a producer may use the dollar export earnings for other purposes, such as investments abroad, purchase of raw materials, insurance payments and others, instead of directly turning into cash revenue. Any indirect benefits received by the producers as a result of an undervaluation will not be counted by the USDOC unless the payments are converted into domestic currencies in a bank. Thus, there is a mismatch between the actual amount of benefits received by a producer and the USDOC's calculation of the amount of benefits during the period of investigation.

Despite uncertainties of measurement and the methodological problems, if the result of the calculation is allowed as a maximum amount of the CVD permitted or the maximum amount of countermeasure - in case a subsidy not withdrawn and recourse to countermeasures is requested and authorized in the WTO dispute settlement - that can be bestowed, it could significantly undermine the WTO system both legally and economically.

Specificity

The USDOC's new rule provides that it will 'normally' consider enterprises that buy or sell goods internationally to comprise a group. The final rule expanded the scope of the term 'group' from the initial proposed rule. The USDOC first proposed that it would consider 'enterprises that *primarily* buy or sell goods internationally' to comprise a group, but has omitted the term 'primarily' from the final rule. Therefore, the USDOC can find a currency subsidy to be specific to the traded goods sector of an economy if it engages in international trade to a certain degree.

In the Vietnam case, the USDOC determined that the 'traded good sector' disproportionately or predominantly used the exchange of foreign currency based on the IMF data on USD inflows to Vietnam. The USDOC determined that this criteria is consistent with the statutory criteria of determining *de facto* specificity under Article 2.1(c) of the WTO ASCM and Section 771(5A)(D)(iii) of the Tariff Act of 1930.

Under Article 2 of the ASCM, a subsidy must be 'specific' to certain enterprise or industry or group of enterprises or industries. This term is both very broad and ambiguous concept. Decisions in the WTO disputes have previously defined the concept of industry or a group of industries as related to producers of certain products. The panel in *United States – Subsidies on Upland Cotton* held that a subsidy would cease to be specific if it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products (WTO, 2005d).

It has been criticized that the USDOC's definition of 'group' does not refer to an identifiable group of enterprises so it is a violation of the ASCM. However, the USDOC argued that the definition of 'group' in the final rule refers to an identifiable group of enterprises, and therefore it is specific. Footnote 4 to Article 3.1(a) of the ASCM states that the standard is met when granting of a subsidy is 'tied to' actual or anticipated exportation or exporting earning. It could be argued that exchange rate policy is 'tied to' export performance because in order for the foreign exchange rate policy to operate,

products must be traded internationally.

However, the currency undervaluation is 'tied to' exchange of currency not to export or import performances (Staiger and Sykes, 2010). An exchange rate policy is contingent upon overall economic situation, not particularly on exports or imports. Also, the USDOC for a long time maintained a position that China's currency subsidy allegation does not meet legal requirement of 'specificity' under the US CVD law. It declined to initiate two CVD cases against China because "the allegations made by domestic producers not meet the statutory standard for initiating an investigation under the requirement that benefits provided under China's unified foreign exchange regime be specific to the enterprise or industries being investigated (Inside US Trade, 2010)." However, the USDOC reversed its position after modifying its regulation regarding a CVD proceeding instead of the changing the statutory criteria of a CVD law in Congress. Furthermore, one could argue that currency undervaluation has not been mentioned in the illustrative list of export subsidies under Annex I of the WTO ASCM.

Whether a traded good sector constitutes a meaning of *de facto* specificity is legally a very contentious debate. As noted in footnote 4 of the ASCM, "the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered an export subsidy within the meaning of this provision." Thus, *de facto* export contingency must be demonstrated by facts, and what facts should be taken into account will depend on the circumstances of a particular case.

CONCLUSIONS

The USDOC adopted a new rule to levy a duty on imports from countries undervaluing their currencies. It reasoned that government intervention in undervaluation amounts to an export subsidy. This action, however, should be sought be caution because it has weak both economic and legal grounds. This could invite serious legal challenges in the WTO and could potentially damage an already fragile multilateral system.

In addition to the economic issues, this study shows that the existing WTO rules are outdated and insufficient to effectively regulate any trade distorting effect that results from a government intervention in exchange rates. Unlike the IMF's Articles of Agreement, which tried to adjust by amending its Articles of Agreement in the wake of the collapse of the par value system, the GATT had not reflected any changes to the international monetary system in its texts although it had opportunities to do so during the Tokyo Round as well as the Uruguay Round. Also, the existing WTO subsidy rules cannot be used to regulate subsidy effects of a member country's exchange policies because the legal arguments that currency undervaluation satisfy the definition of 'subsidy' is weak.

Despite these structural problems, a CVD may be imposed and maintained for some time due to the dysfunctional WTO dispute settlement system. The US government can make an appeal to the AB, simply for the purpose of undermining any negative rulings from a panel proceeding. Even when the USDOC loses a currency CVD case at the CIT, it may merely modify pertinent calculation methodologies instead of repealing the CVD. This situation may lead domestic firms to bring more currency CVD

petitions against imports from countries with volatile exchange rates.

For the foreseeable future, however, it would be legally feasible for the USDOC to discretionarily conduct a currency subsidy investigation. Although the USDOC relied on the Treasury's estimation of currency undervaluation in the first currency CVD investigation against Vietnam, the USDOC is not required to accept the Treasury's calculation method nor the results of its analysis. But as the USDOC made an affirmative final determination on Vietnam and imposed CVD on individual companies based on currency subsidy programs, it opened a Pandora's Box for US industry petitioners.

Augmentation of ASCM has been the priority issue for the WTO reform initiatives. Considering huge potential implications of currency-based CVDs, it is imperative for the WTO Members to agree on proper guidelines that discipline overly excessive use of trade remedy measures.

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