

Currency Wars: A Fresh Look at WTO/IMF Legal and Institutional Issues

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- I. This is well travelled legal terrain – “Woe to ye who ventures forth!”
 - Hufbauer (2006) re China Currency Coalition case: would not pass a motion for summary judgement – a.k.a. the laugh test.
 - Zimmerman (2012) re IMF and WTO rules: we are at the limits of international economic law -- this is an issue for negotiation and power politics not for lawyers and panels.
 - Jackson – IMF and WTO suffer from “treaty rigidity” – and a bitter division, even hatred, between trade and finance officials.
 - Hufbauer’s take on the WTO rules (2006): “stay out of currency sandbox.”

- II. Not all is lost for international economic lawyers because here comes Robert B. Zoellick in his 2/6/2013 WSJ Op Ed entitles “A New U.S. International Economic Strategy”:
 - “The International Monetary Fund also could help set standards about exchange-rate policies and serve as a referee that blows a whistle, even if it cannot penalize. The IMF and the WTO should anticipate this risk and give effect to the existing WTO agreement that economies must ‘avoid manipulating exchange rates... to gain a competitive advantage.’”
 - Bob has read into the WTO a rule that is not explicitly in the WTO Agreements; nevertheless, he has given us the green light to relook at the international legal issues on currency measures.

- III. So it is fair to ask, what has changed in the last 7 years to give us reason to take a fresh look?
 - The financial crisis highlighted attention to the role of currency imbalances in causing the systemic failure of the global financial system.
 - Emergence of a new principle of international economic law: thou shall not cause systemic failure. Operationalizing this principle would involve recognizing that all policies can be arrayed on a spectrum leading either to stability or systemic failure.
 - Increasing use of massive currency intervention against a growing consensus that currency misalignments have major spillover effects.

- A great deal of legal and economic analysis to clarify the effect of currency misalignment on WTO obligations and the legal issues affecting the interplay of WTO and IMF rules.
- Still a great deal of antagonism between the IMF and WTO – and trade and financial officials – and very little creative thinking on how best to address coherently and collectively the currency wars.

IV. Currency Alignments and fundamental rules of the road

- The idea that currencies should be appropriately aligned has been a fundamental principle of international economic law since the elaboration of the IMF and GATT rules.
- You can think of it as akin to the rule that vehicles stay on one side of the road and leave the other to oncoming traffic. The gold standard was like a structural barrier in the design of a superhighway – like a big grassy median or a Jersey wall – to make sure high speed vehicles stay in their lanes.
- The elimination of the gold standard and the introduction of floating exchange rates was like taking out the structural barriers and replacing them with the double yellow lines of IMF Article IV(1). Without the structural barriers, the IMF has a more important enforcement role but without enforcement experience or tools.
- The question is whether the yellow lines are sufficient to ensure that countries stay in their lanes or whether some countries are crowding the oncoming lanes of other travellers.
- Is this a question of the rules, their enforcement or is it more efficient, economically and legally, to let countries move across the yellow lines when they deem it in their interests? Is the yellow line just not very clear on most superhighways or is it just too tough to get countries to stay in their lanes?

V. IMF and WTO Rules of the Game on currency measures – who should make the final four in an international economic law version of March Madness:

- From the WTO, we have as contenders:
 - o “frustration” (Article XV(3))
 - o tariff impairment (Article II)
 - o countervailable subsidies (SCVM Agreement)
- From the IMF, we have
 - o currency “manipulation” (Article IV(3))
 - o not “in accordance with” (Article IV(1))
- At the heart of this are some critical legal value judgments on currency misalignment:
 - o Do all frustrators have to be manipulators?
 - o Is currency manipulation more of a predatory or “unfair trade practice” or should it be decriminalized, that is, seen more as unacceptable collateral damage (e.g. tariff impairment) to otherwise legitimate domestic policies?

- Do you want to provide narrow relief or very broad based relief?
- Paul Volcker: in five minutes, exchange rates can wipe out what it took trade negotiators ten years to accomplish.

VI. Possible prescription for a fresh assessment of the legal options: a hypothetical test case.

- Country A: Assume the most egregious case of direct, massive and sustained intervention with the effect of devaluing a currency accompanied by exchange controls and restrictions to achieve sterilization.
- Country B: Seeks to enforce the most compelling WTO rights: the effect of undervaluation on the protective effects of ad valorem and specific tariff bindings.
- Request a remedy that is measured and temporal to address the damage/injury.
- Enlist the support of the broadest range of WTO and IMF members.

VII. How might such a case proceed under current IMF and WTO rules?

- Based upon Article XV(4) frustration of the right to maintain a certain margin of protection based on tariff bindings under Article II.
- Referral to the IMF for a factual analysis of the extent of misalignment, amount of intervention and other statistical and factual issues and a determination whether intervention amounts to manipulation to achieve a competitive advantage (IMF Article IV(1)(iii)) or otherwise in accordance with the IMF rules. GATT Article XV(9).
- Critical issue #1: Does Article XV(9) create a safe harbor for any and all exchange measures as long as the IMF does not determine that they are not in accordance with IMF rules?
- Critical issue #2: If the IMF cannot conclude that the measures are in violation of IMF rules, must it conclude as a matter of international law that they are in accordance with the rules?

VIII. If a Panel really wanted to find in favor of Country B, how might it legally justify its conclusion?

- Standard of proof: does this finding pass the laugh test? Is it legally plausible?
- Textual argument: Article XV(9) by its terms only provides a safe harbor for “exchange controls” and “exchange restrictions” – and does not extend to massive currency intervention that results in systematic devaluation.
- Additional bases:
 - IMF concludes that the practices amount to “manipulation” to achieve “competitive advantage” or

- If not, IMF members treat the determination that a member is in accordance with IMF rules as equally political as a determination of “manipulation” and refuse to determine that the measures are “in accordance with the IMF rules” for purposes of advising the WTO in connection with its case.
- If the IMF for political reasons cannot determine that a spade is a spade, can it also for political reasons refuse to determine that this spade is not a spade.
- Teleological and institutional arguments: the WTO has an international legal obligation to protect its obligations – and the benefits that flow to members – from nefarious currency practices and as an independent institution has the right to take the advice of the IMF and still reach its own conclusions regarding rights and remedies under its rules.

IX. Is this the best way to proceed?

- The IMF and WTO can be seen as either two very different institutions with competing and overlapping jurisdictions or two very complementary institutions that will hang together or hang separately:
 - IMF has vertical obligations to the institution and very little enforcement power.
 - WTO has horizontal obligations running from member to member with a dispute settlement system to interpret even the most ambiguous rules, apply them to factual cases and authorize remedial action.
- If the IMF and WTO worked together, they could easily achieve an optimal outcome on currency issues:
 - An IMF determination that at some point, a currency misalignment caused by massive and persistent intervention (or some other policy) accompanied by exchange controls and other measures would justify WTO remedial measures, either the renegotiation of tariff concessions, the imposition of a duty to countervail the subsidy effect or the authority to take selective safeguards on a non-MFN basis to address the injury.
- Why pursue a micro solution to a macro problem?
 - The WTO is all about the micro and a micro solution would preserve the fairness and equity of the WTO system particularly for countries with little other recourse, thereby moving the system away from a systemic failure.
 - Even a micro solution would highlight the effects of currency interventions and would generate international pressure by publicizing the practice and its effects.
 - The effects of even micro measures on the political economy can create political pressure for change at the macro level.