Trade and Currency

Can WTO Rules Have a Role?

11.2.2014
Common themes of GATT/WTO

- Bali
- Tariff
- Subsidies
- Protectionist measures
- Market access
- Goods and Services
- Technical Barriers
- NAMA
- Intellectual property
- Doha Negotiations
- Agriculture
- Dispute Settlement
“Currency War”
(Guido Mantega, the Brazilian Minister for Finance, 2010)
The terminology conundrum…

Intentional undervaluation of currency to benefit exports
What does it mean?

• Currency manipulation/misalignment/devaluation by countries

• Lowering value of own currency against foreign currency

• Main intention to increase competitiveness and increase exports

• Currency exchange rate used as a tool to increase exports
What constitutes currency misalignment?

- Currency misalignment or manipulation has not been clearly defined in any of the international agreements dealing with trade and currency issues.

- Notion of an “Equilibrium Exchange rate”

- Manipulating the Exchange Rate by deliberate State action to make it move away from the equilibrium
IMF Agreement

Article IV, inter alia, states

“In particular, each member shall: ... avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.”

(However, extreme caution has been advised in determination of misalignment and the benefit of any reasonable doubt would be given to the authorities in establishing whether fundamental misalignment is present)
“(a) "Manipulation" of the exchange rate is only carried out through policies that are targeted at—and actually affect—the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.”

“In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.”
G 20 and Currency Wars...
G-20 Communique
Meeting of Finance Ministers and Central Bank Governors
Moscow, 15-16 February 2013

“We reiterate our commitments to move more rapidly toward more market-determined exchange rate systems and exchange rate flexibility to reflect underlying fundamentals, and avoid persistent exchange rate misalignments and in this regard, work more closely with one another so we can grow together.”
Does WTO have a role?

• Is there a trade issue?

• Is there a violation of any of the obligations under WTO Agreements?

• Is there redress under any WTO Agreement?

• Is there a case for a dispute settlement proceeding?
Rumblings of a Currency issue at the WTO

**April 2011**
- Set in motion by Brazil by submission of a proposal to the Working Group on Trade, Debt and Finance (WGTDF) proposing a debate with a view to better understanding

**September 2011**
- Another Brazilian proposal highlighting the intricate relationship between exchange rate misalignments and multilateral trade rules – Discussion of possible trade remedies

**September 2011**
- WTO Secretariat paper on the relationship between exchange rates and international trade
March 2012

- Workshop held at WTO to deliberate on the issue

November 2012

- Brazil initiated another proposal on exchange rates and international trade – existing trade remedies not appropriate to address the issue and new trade remedies required

November 2012

- The WTO seems to be systemically ill-equipped to cope with the challenges posed by the macro and microeconomic effects of exchange rates on trade

- Members may wish, against this background, to consider the need for exchange-rate trade remedies and to start some analytical work to that effect.
China’s reaction to Brazil’s November 2012 proposal

"Currency issue in nature is a monetary policy issue. The right path to resolve this issue is by enhancing the responsibility of and promoting coordination among the international reserve currency issuers."

(http://www.reuters.com/article/2012/11/26/us-wto-currencies-idUSBRE8AP0XJ20121126)
Currency Undervaluation and compatibility with International Economic Law

GATT

Currency Undervaluation

IMF Agreement

SCM Agreement
WTO provisions involved

General Agreement on Tariffs and Trade
  – Article XV GATT – Exchange Arrangements
  – Article II GATT – Tariff Commitments

SCM Agreement
  – Whether a subsidy under Article I, SCM Agreement
  – Whether a prohibited subsidy under Article 3, SCM Agreement
Is Currency Manipulation a violation of WTO obligations?

Violation of Article XV GATT

Article XV (4) GATT
“Contracting parties shall not, by exchange action, frustrate* the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.”

“Ad Article XV

“Paragraph 4
The word “frustrate” is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article.
Relevant terms to interpret…

• What is an Exchange action?
  – Broad interpretation
  – Could include exchange rate policy

• What amounts to “frustrate”
  – make ineffectual", "counteract" or "invalidate”
  – “prevention of success or fulfillment”

• “the intent of the provisions”
  – Not all provisions

Article XV (4) of the GATT definitely offers an opportunity to the critics of currency misalignment to attempt a legal challenge at the dispute settlement forum. That the provision has not been tested or interpreted may not be reason enough for the claim not to succeed.
Violation of Article II GATT commitments

- Article II of the GATT is one of the basic provisions of the multilateral trading system. It lays down the tariff concessions that a country is bound to under the international rules.

“1. (a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.”

- When tariff concessions are bound the duties assessed on the bound items may not be greater than the bound rate.

- Bindings give legal assurance that tariffs will not be raised beyond the maximum tariff level.
Article II GATT continued...

Currency misalignments may result in the actual tariff being much higher or lower than the bound rate of tariffs as per the schedule of commitments.

By a “tariffication” exercise, undervaluation of a currency may lead to the applied rate crossing the bound rate.

Currency undervaluation could upset a country’s tariff bindings pursuant to Article II of the GATT.
Violation of SCM Agreement?

Whether it is a subsidy contingent on exports under Article 3 ASCM?
Financial contribution…

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

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);”
“Prohibited subsidy” under the SCM Agreement?

Article 3.1- 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…

Currency misalignment policy is also seen as constituting a “financial contribution: conferring a “benefit to the exporters” and “contingent on exports” and are viewed as being incompatible with the provisions of the ASCM.
Currency Manipulation – No WTO violation?

- Not an exchange action under Article XV
- Article II GATT not violated
- Not a case that falls under the Dispute Settlement process
- Does not constitute a subsidy under the ASCM
- Deference to IMF
Issue of the Right Forum…

IMF is the legitimate international institution to address currency exchange rate issues.

WTO has the strength of the dispute settlement process that ensures enforceable decisions.
Currency manipulation and domestic policy space

Currency Exchange Rate Management
- Variety of objectives
- Macro-economic policy space
- Exercise of domestic will
- Monetary Policy

International Economic Law
- Impact on trade
- Unfair advantage
- Cannot be misused for hurting others trading interests
- International law provides for limits of exercise
Complexities and concerns…

• Monetary policy complexity – Thin line between exercise of domestic monetary policy and exchange rate manipulation

• Complex econometric models and macro-economic policy issues

• No unanimity on what constitutes “currency manipulation” as well as whether impacts trade at all
Recent developments…
US Auto industry and currency manipulation in TPP
9th January 2014

(http://www.youtube.com/watch?v=r2kv37S3Sn4)

“Given the interconnection between trade and finance, to achieve an ambitious result, the trade pact must ensure that currency manipulation by a TPP member does not frustrate the market access commitments set forth in the final agreement.

...  

The American Automotive Policy Council, on behalf of its members, Chrysler, Ford and General Motors, calls for the inclusion of strong, enforceable currency provisions in the Trans-Pacific Partnership (TPP) Agreement.”
PRINCIPAL TRADE NEGOTIATING OBJECTIVES

“(11) CURRENCY.—The principal negotiating objective of the United States with respect to currency practices is that parties to a trade agreement with the United States avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other parties to the agreement, such as through cooperative mechanisms, enforceable rules, reporting, monitoring, transparency, or other means, as appropriate.”
Currency manipulation provisions in trade agreements

Demand by domestic policy makers

“Undervalued exchange rates allow other countries to boost exports of their products and impede exports of ours.

... Including currency disciplines in the TPP is consistent with and will bolster our ongoing efforts to respond to these trade-distorting policies.
“Currency manipulation can negate or greatly reduce the benefits of a free trade agreement and may have a devastating impact on American companies and workers.”

As the United States negotiates TPP and all future free trade agreements, we ask that you include strong and enforceable foreign currency manipulation disciplines to ensure these agreements meet the "high standards" our country"
What next?...

• Who will fire the first bullet?

• Does the Dispute Settlement Understanding prevent filing of a case under the WTO?

• Will a Member file a WTO case or initiate domestic CVD investigation against another “manipulator” Member?

• Will there be more discussion in the WTO Committees/Councils?

• Will it be covered in a Free Trade Agreement?

• Will there be a move towards a new international legal or policy framework?
Will “currency manipulation” be the next big trade dispute in this decade at the WTO?
(http://www.youtube.com/watch?v=zOtYkrwr2UE)
Thank You

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