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To Manipulate or Not
Currency misalignment, trade law and the search for solutions

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I. Introduction

The issue of the interface of currency manipulation and trade law has been a less explored and contentious one. While the need to address the issue deliberate currency undervaluation in the context of trade is raised, it is still unclear what rules of the game prevail in such a situation.

The Governor of the Reserve Bank of India recently opined[1] that there is a need for new rules of the game for regulation of monetary policies of national macroeconomic authorities. He stated that central banks in developed countries find all sorts of ways to justify their policies without acknowledging the unmentionable – that the exchange rate may be the primary channel of transmission. If so, he concluded, what we need are monetary rules that prevent a central bank's domestic mandate from trumping a country's international responsibility. He called for an international agreement along the lines of Bretton Woods with some reinterpretation of the mandates of internationally influential central banks.

An earlier Reserve Bank of India Working Paper[2] highlighted the need to initiate discussion on this issue.This is a significant statement in the light of the debate of currency manipulation[3] and international trade. While deliberate attempts to intervene in the foreign exchange market is seen as breaching the mandate of non-manipulation of currencies for gaining competitive advantage, other measures like "Quantitative Easing" by central banks have been off the radar.

The relationship between exchange rate management and international trade has been a longstanding and inextricable one[4]. The debate has evolved around terminologies such as currency misalignment, currency undervaluation and currency manipulation. It has been contended that an undervalued exchange rate (depreciated currency) boosts a country's

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[1] https://www.project-syndicate.org/commentary/new-monetary-policy-rules-needed-by-raghuram-rajan-2016-03.

[2] A more detailed working paper in March 2016 titled "Rules of the Monetary Game" explains in detail the proposal to initiate discussion on the issue of monetary policy and currency undervaluation. This is discussed later in the paper. See https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=16821

[3] Currency misalignment, manipulation, undervaluation are all interchangeably used in this analysis. In simple terms, it refers to a situation where the exchange rate of a currency (in comparison to foreign currencies) is substantially lesser than its actual or real value.

[4] See Paul Krugman's assessment in this New York Times editorial - http://www.nytimes.com/2010/03/15/opinion/15krugman.html?_r=0.

exports by making it's goods more competitive in the global market and thus enhancing exports and inhibiting imports. The impact of exchange rate on international trade is also a subject of extensive economics literature wherein the question of the effect of depreciated currency on the volume of trade has been studied. However, currency misalignment or manipulation has not been clearly defined in any of the international trade agreements. It "occurs when a government buys or sells foreign currency to push the exchange rate of its currency away from its equilibrium value or to prevent the exchange rate from moving toward its equilibrium value."[5] Thus, essentially it implies that when countries "deliberately" or "intentionally" undervalue or manipulate their currency to gain a competitive advantage to boost exports, a situation of unfair advantage occurs.

In a Decision by the International Monetary Fund (IMF) in June 2007[6], 'manipulation of exchange rate' has been given extensive explanations. Avoiding manipulation is a specific obligation of the members, as described in the Decision. As per Article IV[7] of the IMF Agreement members are required to avoid manipulating exchange rates in order to gain an unfair competitive advantage over other members. The 2007 decision details out this obligation but is extremely cautious at coming to decisions that would determine a violation of an obligation by a member. Bilateral surveillance by the IMF is mandated under certain circumstances that include a fundamental misalignment of currency. The guidance provided[8] in the 2007 Decision as to what constitutes a "manipulation" of exchange rates is as follows:

> "…
> *(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.*
>
> *(b) A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken "in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other*

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5 Joseph E. Gagnon, "Combating Widespread Currency Manipulation", Peterson Institute for International Economics, Number PB12-19, July 2012.

6 IMF June 2007 decision is found here - http://www.imf.org/external/np/sec/pn/2007/pn0769.htm

7 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; …"

8 Annex I of the IMF 2007 decision

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.

3. It is the responsibility of the Fund to make an objective assessment of whether a member is observing its obligations under Article IV, Section 1 (iii), based on all available evidence, including consultation with the member concerned. Any representation made by the member regarding the purpose of its policies will be given the benefit of any reasonable doubt.

…"

Thus, though "currency misalignment" is not defined in clear terms in the IMF Decision of 2007, guidance is provided to the IMF and the members about the circumstances under which a currency misalignment may arise.

Currency misalignment is also not defined in any provision of the General Agreement on Tariffs and Trade 1994 (GATT 1994) or other Agreements under the World Trade Organization (WTO). However, there are a number of provisions under GATT 1994 that deal with the issue of currency exchange, action and arrangements that could have a bearing on an understanding of the compatibility of currency misalignment with WTO law. Currency misalignment or manipulation, though discussed at length in international political fora, has not been the focus of either the WTO as a negotiating forum or under the dispute settlement mechanism of the WTO. That not a single dispute amongst the over 500 cases that relates to currency misalignment issues is testimony to the fact that this complex subject has not been dealt with by WTO members as a WTO law violation. While the existence and jurisdiction of the IMF has been partially responsible for the reluctance of currency misalignment taking centre-stage at the WTO (either at negotiation or dispute settlement), the possibility of a dispute in the coming years has not been ruled out.

It is also pertinent to note that the G-20 Meeting of Finance Ministers and Central Bank Governors in February 2016has referred, as in earlier communications, to the issue of exchange rate misalignment and trade in their statements. The latest G-20 Communique[9] emphasized the need to refrain from competitive devaluations[10].

[9] http://www.g20.utoronto.ca/2016/160227-finance-en.html

[10] *"We reiterate that excess volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability. We will consult closely on exchange markets. We reaffirm our previous exchange rate commitments, including that we will refrain from competitive devaluations and we will not target our exchange rates for competitive purposes.*

The debate on the impact of exchange rate policies on international trade, however, has not prominently been on the agenda of the WTO though discussions on the inter-relationship between currency manipulation and trade have taken place in the Working Group on Trade, Debt and Finance (WGTDF). The issue also repeatedly comes up in the domestic political discourse in the US primarily targeting alleged practices of China and other major trading partners. There have been strong demands to include strong and enforceable provisions relating to currency manipulation in the Trans Pacific Partnership (TPP).This was apparently prompted by Japan's entry into the TPP negotiations and a possible future entry of China. Thus, the issue of currency manipulation or misalignment is a substantially sensitive topic in the context of US trade policy strategies too. Influential academic think tanks[11] in the US have also provided policy inputs on currency misalignment and trade for a long time now. The issue of currency misalignment must also be seen in the context of the Chinese renminbi. There are often voices in the US that accuse China of deliberately undervaluing its currency in order to boost its export competitiveness. Though the US has not formally raised this issue in the WTO yet, domestic voices often accuse China of following a policy of currency undervaluation to subsidize its exports.

However, the results in the TPP on currency surprised many who were following this debate. The TPP is often referred to as the gold standard in preferential trade agreements.[12] However, the expectation of such a standard being achieved in the context of currency manipulation is debatable. That would perhaps been a precursor for a multilateralization of such provisions at the WTO. The enforcement mechanism of the dispute settlement system has been viewed as the strength of the WTO. Thus, the preferred forum to adjudicate the issue could be the dispute settlement mechanism of the WTO while the contours of what constitutes currency misalignment needed to be determined by the guidelines prescribed by the IMF. This merger has not been easy to achieve. And the TPP result is a clear indication of it.

We will resist all forms of protectionism. We will carefully calibrate and clearly communicate our macroeconomic and structural policy actions to reduce policy uncertainty, minimize negative spillovers and promote transparency."

[11] The Peterson Institute for International Economics is one of the think tanks that is at the forefront of this debate in the US.

[12] http://www.huffingtonpost.com/eastwest-center/tpp-the-new-gold-standard_b_9544428.html

II. Moves at the World Trade Organization (WTO)

Though the issue of currency manipulation has not gained the degree of prominence that proponents would have wanted it to have at the WTO, it has seen some initial advances. In April 2011, Brazil submitted a proposal[13] to the Working Group on Trade, Debt and Finance (WGTDF) of the WTO proposing "a debate with a view to better understanding the issues involved and their implications for members of the WTO."The Brazilian proposal[14] recommended a Work Program for the WGTDF which essentially had two pillars: an economic approach based on academic research and concrete experience[15] and an institutional approach[16].A number of proposals[17] for workshops, research papers and seminars were called for in this proposal. The proposal of Brazil set in motion a preliminary discussion on the issues of exchange rate misalignment and trade in the WTO.

Though the proposal was not part of the discussion in the negotiating agenda of the Doha Development Agenda, it initiated the discussion of this complex relationship in the

[13]WT/WGTDF/W/53

[14] *"However, the more specific macroeconomic dynamics between exchange rate and foreign trade is an issue that is yet to be better understood and addressed in international forums, against the background of the international crisis triggered in 2008. The time has come to do so in an institutional and structured way. There can be arguably no better locus for that exercise than the WTO Working Group on Trade, Debt and Finance (WGTDF) that was created by the Doha Ministerial Declaration."*

[15]The first pillar was essentially to study the link between exchange rate misalignments and international trade in terms of economic theory and real case studies.

[16]The second pillar deals with looking at the coherence mandate of the WTO and how it has been implemented in the context of the relationship between exchange rate and trade.

[17] The proposals were as follows: *Requesting the Secretariat to prepare an updated review of available literature and research, particularly in the light of the crisis that started in 2008. The Secretariat should consult Members on any literature that they may wish to indicate; Undertaking, in one of the sessions of the WGTDF, a dedicated workshop with the participation of selected economists, as agreed by Members; Sharing of concrete experiences and case studies by WTO member countries, on a voluntary basis, in the form of presentations at the WGTDF sessions, ideally made by capital- based senior officials who are directly responsible for policy making; Commissioning of any study or discussion paper that the WGTDF might consider to be useful as an input into the debate; Commissioning two discussion papers - one to be prepared by independent experts, after consultation to Members, another jointly by the WTO, the IMF, and the World Bank – on how the "coherence mandate" is being implemented with respect to the relationship between exchange rate and international trade. The discussion papers will be encouraged to propose measures, if any, that might contribute to strengthening the "coherence mandate" among the WTO, the IMF and the World Bank; Organizing a workshop in one of the sessions of the WGTDF to debate the discussion papers referred to above.*

multilateral trading institution. In September 2011, Brazil initiated another proposal[18] which highlighted the intricate relationship between exchange rate misalignments and multilateral trade rules under GATT 1947 and GATT 1994. This proposal essentially suggested that the WGTDF examines available tools and trade remedies in the existing multilateral system, if any, to compensate for or otherwise redress those currency fluctuations that may impair commitments undertaken by Members in successive rounds of negotiations. In addition, the proposal contended that addressing that issue may help prevent the overstretching of multilateral trade rules as regards, for instance, provisions on safeguards, antidumping, subsidies and countervailing measures, as well as bound tariffs.

Thus, this proposal progressed from the initiation of the debate around exchange rates and trade in the first proposal to discussing the possible trade remedies available under the multilateral trading system to address the issue of currency misalignment. Thus, it was a progression from an understanding on the possible relationship between exchange rate and trade to the possible remedies in the trading system to tackle the problem of currency manipulation. Brazil, as a first step, proposed to examine the specific topic covered in this submission in a workshop that could take place in 2012.

In September 2011 the WTO Secretariat circulated a paper[19] titled "The Relationship between Exchange Rates and International Trade: A Review of Economic Literature" which basically was a follow up on Brazil's "first pillar" in its proposal of April 2011 and concluded[20] with mixed findings.

In March 2012, an international workshop was held in WTO to deliberate on this issue. In November 2012, Brazil initiated another proposal[21] on exchange rates and international trade. Titled "The Relationship Between Exchange Rates and International Trade: Exchange-Rate Misalignment and Trade Remedies: A Conceptual Note by Brazil" it discussed exchange rates in the history of GATT/WTO, the various provisions in the

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[18] WT/WGTDF/W/56

[19] WT/WGTDF/W/57

[20] *"On the issue of the level of exchange rates (misalignments), theoretical and empirical studies over the years show that the relationship between the level of a currency and trade is so multi-faceted and complex that it is hard to take a firm line in any particular direction. Economic theory suggests that when markets are free of distortions, an exchange rate misalignment has no long-run effect on trade flows, as it does not change relative prices. But long-run effects are predicted in models that assume market distortions, such as information problems or product market failures. In the short-run, when some prices in the economy can be sticky, movements in nominal exchange rates can alter relative prices and affect international trade flows. These short-run trade effects, however, are not straightforward, as they are likely to depend on specific characteristics of the economy, including the currency in which domestic producers invoice their products and the structure of trade (for example, the prominence of global production networks). On the empirical side, the complexity of the relationship between exchange rate misalignments and trade yields mixed findings. For instance, a currency undervaluation is sometimes found to have a positive impact on exports, but the presence, size and persistence of these effects are not consistent across different studies."*

[21] WT/WGTDF/W/68

multilateral trading system applicable to exchange rates and trade as well as whether the traditional trade remedies in the GATT/WTO like countervailing duties, anti-dumping duties and safeguard measures are appropriate to deal with the issue of currency misalignment. The proposal concluded[22] with the assertion that the existing trade remedies may not be appropriate to address the issue and there may be a need to craft new trade remedies that address the issue of currency misalignments. It also proposed a non-exhaustive list of key elements like measuring currency misalignment[23], product-specific/sector-specific or economy-wide scope[24], time-frames appropriate for application of corrective measures[25], relevance of the origin of the products[26], injurious effects[27] and the need for investigative procedures[28] as next steps for the analytical work. Thus, this proposal pushed the debate even further in terms of discussing possible new trade remedies to address the issue of currency misalignments.

As of 2015, here has been no perceptible progress in the WTO for an initiation of substantive discussions on possible new trade remedies for currency misalignment. The WTO Secretariat has come up with a factual report on the experience under Article II.6 of the GATT. In a recent meeting of the Working Group on Trade, Debt and Finance held in September 2015 the issue continued to be discussed without any specific way

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[22]"Existing provisions related to exchange-rate movements in the WTO agreements as well as the three Agreements providing for trade remedies at the WTO were created to deal with situations unrelated to the dynamics of exchange-rate movements in today's volatile international monetary system. 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."

[23]"It will be necessary to define methodologies to assess currency misalignments and to establish triggers/benchmarks for specific action..."

[24]"Should corrective measures be applicable only to a specific product or sector in the country affected or to its entire economy? What are the implications of either choice?..."

[25]"…The argument could be made that sustained long-term misalignments would no longer be a misalignment; rather, they would become a new structural point of equilibrium. The discussion on time-frames would equally touch on review and extension/termination of corrective measures."

[26]"Should corrective measures be applied on an MFN basis or specifically for currencies against which the misalignment is found? As exchange rate misalignments may not necessarily occur against a large number of key trading partners and may have a focus on bilateral trade (or on a wider volume of world trade representing in any case the sum of a certain number of bilateral trade flows), it may be the case to consider a non-MFN approach."

[27]"Corrective measures could be crafted to be triggered automatically or, alternatively, following the finding of injury or threat of injury to the domestic industry. The automatic format would probably demand more stringent requirements."

[28]"The need for investigation procedures would depend largely on the automaticity of the mechanism adopted. The more automatic, the less need for such procedures. In case these procedures are necessary, work could be inspired by the parameters found in the ADA, ASCM and AS."

forward. While multilateral movement on this issue seems remote either in terms of rule-making or agenda setting, the expectation that mega-regionals outside the WTO would offer fresh perspectives was unavoidable. With the Doha Development Agenda negotiations facing an impasse and the contours of the post-Nairobi negotiations being unclear, currency manipulation issues seems unlikely to dominate or find a prominent place in the WTO's negotiating agenda in the imminent future.

III. Currency Manipulation and Trade Law

The issue of the relationship between currency manipulation and international trade law has been contentious. From being viewed as embedded in GATT provisions to being a countervail able subsidy under the Agreement on Subsidies and Countervailing Measures (ASCM), currency manipulation has now found its way into proposed mega-regional trade agreements. The United States also has domestic legislation addressing the issue. However, there has been no dispute relating to currency manipulation under the dispute settlement mechanism so far.

a. Breach of WTO Law?

Legal literature is overwhelmingly against the sustainability of a WTO claim in respect of a currency manipulation practice. Such a claim and a decision on it would indeed be a unique one in the history of dispute settlement at the WTO. However, there are strong proponents who argue that provisions of the GATT and ASCM are violated. A broad overview of the literature is provided herewith to highlight the possible provisions that may be invoked in a dispute.

The proponents of a currency misalignment challenge under the WTO law argue that currency misalignment, under certain circumstances, is incompatible with a country's obligations under Article II and XV of GATT 1947. For countries with a depreciated exchange rate: depending on the level of such depreciation, their bound and applied tariffs can be increased in greater proportions than the exchange rate. For countries with a small difference between applied and boundtariffs, any depreciation may imply that applied tariffs surpass the limits negotiated within the WTO, violating Article II of the GATT.[29]They argue that with the impacts of exchange rates, tariff structures become less transparent and much less predictable, in the present context of exchange rates' fluctuations or manipulations. Currency misalignment is also seen as frustrating the intent of GATT provisions (especially Article II of GATT) under Article XV of GATT. Further, that it constitutes a "prohibited subsidy" under the ASCM. Currency

[29]Vera Thorstensen, Emersn Marcal, Lucas Ferraz, "Impacts of Exchange Rates on International Trade Policy Instruments: The Case of Tariffs".

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. They could, they argue, constitute a prohibited subsidy under the ASCM and can be potentially challenged under the dispute settlement mechanism.

There is substantial legal literature that rejects a WTO claim on the grounds that currency misalignment cannot be addressed by the present rules. It states that neither are GATT provisions violated nor are the conditions of the ASCM satisfied to constitute a subsidy under the ASCM. Since there is no WTO jurisprudence in this matter, one would have to wait for a Panel or Appellate Body to decide on this issue, if a dispute on currency manipulation is brought before it. The credibility of the WTO's dispute settlement mechanism is one of the main reasons for many experts[30] to propose a WTO challenge as compared to the remedies that the International Monetary Fund (IMF) provides. Both a direct challenge at the WTO and a unilateral measure (countervailing duty investigation) are suggested routes. Many[31] have felt that a unilateral measure would be preferred to a WTO challenge since it has many advantages.

Demands for amending the existing legal framework and enacting a new international framework to address the issue of currency misalignment is also one of the ways forward that have been recommended. Arvind Subramanian and Aditya Mattoo[32] have offered

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30 See Jonathan E. Sanford, "Currency Manipulation: The IMF and WTO", Congressional Research Service Report, January 28, 2011.

"There has also been increased interest, in recent years, in the issue of currency manipulation and its impact on world trade and financial relationships. It could be argued, therefore, that this might be an appropriate and perhaps auspicious moment for issues relating to the trade impact of currency manipulation to be raised in the WTO dispute adjudication process."

31Benjamin Blasé Caryl, "Is China's Currency Regime A Countervail able Subsidy? A Legal Analysis Under the World Trade Organization's SCM Agreement", 45:1 J.W.T.

32Arvind Subramanian and Aaditya Mattoo, "Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization", Centre for Global Development, Working Paper No.142, February 2008

"Any new rules should not be expedient and ad hoc, targeted at specific countries and tailored just to meet today's problems. Rather they should be such that their rationale and usefulness outlive current circumstances. In terms of content, procedures, and caveats, new rules could draw upon existing ones.

First, any new rules would need to stipulate that undervalued or substantially undervalued exchange rates that stem clearly from government action act like import tariffs and export subsidies. The rule would therefore have two conditions: a clear finding of undervaluation and its demonstrable attribution to government action.

Once these two conditions are established, it would be as if GATT rules that prevent tariffs and other this as a credible way forward. This would involve negotiations and a discussion at the multilateral forum. Brazil's recent conceptual note in November 2012 at the WTO also suggests that existing provisions related to exchange-rate movements in the WTO agreements were created to deal with situations unrelated to the dynamics of exchange-rate movements in today's volatile international monetary system and conclude that 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.

The legal and technical complexity of the subject matter is often sighted as a ground for not pursuing a legal remedy. It is an untested area and a WTO panel and Appellate Body may lead to new jurisprudential insights on the relationship between currency misalignment, trade and WTO law compatibility. However, the mere complexity of a currency misalignment issue may not be reason enough that it is not pursued as a WTO law violation.

Another important issue related to currency undervaluation is the thin line between domestic macroeconomic decision making involving "Quantitative Easing[33]" and deliberate measures undervaluing one's currency. While some have argued[34] that domestic measures like "Quantitative Easing" fall outside the scope of the IMG

charges beyond previously specified ceilings and export subsidies in any form are violated."

[33]Quantitative easing is a monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity. (http://www.investopedia.com/terms/q/quantitative-easing.asp)

[34] http://www.iie.com/publications/briefings/piieb16-4.pdf

"The consultations on macroeconomic policies can and undoubtedly will include monetary policies, such as quantitative easing (QE) as practiced recently by the United States and currently by Japan. Some US officials and members of Congress have expressed concern that other countries might seek to characterize QE as "currency manipulation" by the United States itself, on the ground that QE can lead to a currency depreciation. That is certainly a possibility. But there is widespread international agreement that there are fundamental differences between QE and manipulation: QE pursues **domestic** economic goals through the use of **domestic** policy instruments, while manipulation by definition refers to direct intervention in the markets for **foreign** currencies. In addition, QE **increases** global as well as domestic demand by increasing the growth of the country involved, while manipulation simply shifts demand from one country to another by reorienting and indeed distorting trade flows. Finally, QE **enhances** the economies of trade partners while manipulation **weakens** them. Accordingly, the fear that the new declaration and its consultative group could disrupt the use of legitimate policy instruments by the United States or any other TPP member is groundless."

See also https://newrepublic.com/article/120840/europes-quantitative-easing-program-not-currency-manipulation

Guidelines of 2007 which clarified the specific contours of what constitutes currency manipulation, others tend to believe that the demarcation is not always clear[35].

The recent piece by India's Reserve Bank of India Governor and the related Working Paper referred to earlier raise the issue of the thin line being breached[36]. The Working Paper highlights that certain domestic macro-economic policies do have consequences (both positive and adverse) on other economies (called "spill over effects") which need to identified and addressed. Three types of policies[37] are referred to in terms of their possible spill over effects[38]in other economies. It is argued that in practice, it may be difficult to determine the underlying rationale of a policy in terms of its impact on the exchange rate. Even indirect policies, regardless of intent or purpose, can also effect the level of the exchange rate and may be construed as "currency manipulation" to gain a competitive advantage.

Others have argued that macroeconomic authorities do have the policy space to undertake these actions.[39] Reference is also drawn to para 15 of the IMF Decision of 2007 which lists out the developments which would require bilateral surveillance and follow up with members in terms of currency manipulation relating to obtaining a competitive advantage. The developments that need to be considered include "protracted large-scale intervention in one direction in the exchange market", "official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks,

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35 http://www.zerohedge.com/news/2015-04-03/europes-currency-manipulation where it has been argued "At its core, currency manipulation is any intentional intervention that results in an undervalued currency and a substantial current-account surplus – exactly what the ECB is doing. If the ECB maintains this policy for an extended period, tension with the US is all but inevitable – tension that may obstruct the TTIP's approval by the US Congress or hinder the treaty's actual operation, resulting in its deterioration or termination." See also http://www.cnbc.com/2014/04/14/currency-manipulation-the-ecb-finally-said-itcommentary.html

36 https://www.project-syndicate.org/commentary/new-monetary-policy-rules-needed-by-raghuram-rajan-2016-03

37 (i) Direct or "evident" exchange rate manipulation e.g. through massive intervention in the foreign exchange market which aim to depreciate a country's exchange rate or not let it appreciate, or keep it "undervalued" relative to some benchmark. (ii) Other "discreet" or indirect policies that have similar beggar-thy-neighbour effects. Unconventional monetary policies could potentially belong to this category. (iii) Policies that can have financial sector spill overs such as capital flows, high credit growth, and asset price bubbles, could also be considered as generating large adverse spill overs through the financial system. Low interest rate policies for long in advanced economies could fall in this category.

38"Easy monetary conditions in advanced economies can lead to capital inflows, exchange rate appreciation, rapid credit growth, and asset price bubbles in emerging markets (EMs). On the other hand, monetary normalization, or a rise in interest rates in advanced economies can cause capital outflows and exchange rate depreciation in the EMs." https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=16821 at page 8.

39 https://www.project-syndicate.org/commentary/trade-negotiations-currency-manipulation-by-jeffrey-frankel-2015-06

or excessive and prolonged accumulation of foreign assets, for balance of payment purposes", "restrictions on or incentives for, current transactions or payments for balance of payment purposes", "restrictions on or incentives for the inflow or outflow of capital for balance of payments purposes", "the pursuit of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows for balance of payment purposes", "fundamental exchange rate misalignment", "large and prolonged current account deficits or surpluses" and "large external sector vulnerabilities arising from private capital flows". Proponents[40] of quantitative easing argue that the above mentioned developments do not cover domestic macroeconomic policies that have a "secondary impact on foreign exchange rates."

With Brazil[41] having raised the currency misalignment issue at the WTO with detailed submissions, asking for a detailed study to be undertaken and substantial discussion in the WGTDF, it is undoubtedly going to take centre stage in multilateral trade relations and at various international fora at some point in the future depending on the seriousness the situation.

The possibility of a trade dispute related to a currency misalignment, though unlikely, cannot be entirely ruled out. The failure of political negotiations to address this issue and the "soft options" tried out in mega-regionals may force members to seek redressal through the dispute settlement process. While the sustainability of a WTO claim against currency misalignment is a matter of conjecture, it cannot be denied that there is a strong possibility of a challenge.

b. Trans Pacific Partnership (TPP) and Currency manipulation – Soft Landing?

With the multilateral trading forum not offering any solutions to those who seek it, alternate battlegrounds take precedence. There was an expectation that mega-regionals would address the issue for the first time in a trade agreement. However, for those expecting "strong and enforceable" provisions in the TPP on currency manipulation, the resultant Declaration would have been a disappointment. It indicates the complexity of the issues involved, the uncertainty attached to the consequences on one's own monetary

[40]TPP in Focus: the need to address currency manipulation in TPP, and why U.S. monetary policy is not at risk", Trade Resource Center, February , 2015

policy and the reluctance on the part of trade negotiators to dive full-fledged into the issue in a trade agreement.

Though the TPP did not have provisions relating to currency misalignment, it did produce a side-letter "Declaration" which is a Joint Declaration of the Macro Economic Policy Authorities of the TPP Countries. Thus, it is not a separate chapter or part of the Agreementbetween the members but a Declaration by macroeconomic policy authorities (which would be the Federal Reserve in case of the United States) which deal with macroeconomic policy of TPP countries. The Declaration is a statement of intent and consists, inter alia, of transparency obligations that each authority would have to follow.

The Declaration has an overarching objective of strengthening the co-operation of the authorities on "macroeconomic and exchange rate policies." It recognizes that "allowing real exchange rates to adjust in line with economic fundamentals facilitates smooth macroeconomic adjustment, helps to avoid prolonged external imbalances, and promotes strong, sustainable, and balanced global growth." The objective stated in the Declaration is to promote through transparency and dialogue, "market-determined" and "transparent exchange rate regimes" that allow real exchange rates to adjust to reflect underlying economic fundamentals.

On specific obligations with respect to exchange rate policies that the macroeconomic policy authorities undertake in the Declaration, it is clear that they bind themselves to 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. They further undertake to refrain from competitive devaluation and not targeting its country's exchange rate for competitive purposes. Thus, deliberate acts of devaluing currency to enhance the country's export competitiveness is not viewed favourably by the authorities.

The Declaration also lays down certain transparency and reporting requirements that the authorities need to undertake periodically. This includes a list of steps[42] that the

[42]Each IMF Article IV Staff Report on its country, including the exchange rate assessment; Monthly foreign exchange reserves data according to the IMF's Special Data Dissemination Standard ("SDDS") template; Information on quarterly intervention in spot and forward foreign exchange markets; Quarterly balance of payments portfolio capital flows; Quarterly domestic "broad" money stock; Quarterly exports

authorities need to undertake in terms of disclosing publicly the following information within certain prescribed timelines.

Apart from obligations on non-manipulation of exchange rates for competitive advantage and transparency and reporting obligations, the Declaration also embarks on an institutional structure for mutual dialogue and consultation amongst the macroeconomic policy authorities. It is interesting to note that a multilateral Group of TPP Macroeconomic Officials has been established consisting of a senior macroeconomic policy official. The Group is tasked with the mandate of considering the macroeconomic and exchange rate policies of each TPP country, especially the effects of such policies on other TPP countries, issues or challenges with respect to transparency or reporting and the policy responses which address imbalances.

Thus, the Declaration has a three-fold objective – one of reiterating the resolve of not manipulating one's exchange rate to obtain an unfair competitive advantage, of ensuring transparency and reporting on key statistical information relevant to currency manipulation and finally on creating a platform for continuous multilateral dialogue on exchange rate policies between the authorities.

The Minority Staff Report of the US House of Representatives Committee on Ways and Means[43] of the 114th Congress in its detailed analysis of currency manipulation provisions in the TPP was critical of the change in status quo that the TPP provisions actually brought about. It notes that the Declaration recognizes a number of principles but that they do not serve as formal obligations. Further, these obligations are not new as compared to the obligations under the International Monetary Fund (IMF). The Consultation platform is also not considered a substantial improvement over existing consultation mechanisms. Though transparency requirements do entail a higher degree of commitment than what authorities do now, the reporting requirements do not tend to offer confidence of a substantial improvement on existing reports. The lack of enforcement is seen as the biggest drawback. Thus, doubts have been raised on the effectiveness of this Declaration in tackling the issue of manipulation due to the lack of

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and imports and Confirmation that it is participating in the IMF Currency Composition of Official Foreign exchange Reserves ("COFER") database.

[43]http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/TPP%20Issue%20Analysis%20-%20Currency%20Manipulation.pdf

enforceable norms as well as inapplicability of the dispute settlement mechanism of the TPP to this Declaration. Critics have argued that the TPP needed to have stronger, enforceable rules that clearly outline the circumstances of currency manipulation and the remedial steps that could be taken to address the practice.

Others[44] have argued that the TPP has achieved an "important distinction" in the history of trade policy by being the first trade agreement to explicitly link macroeconomic policies and exchange rates. The Declaration is seen as a substantial progress in the cause of stopping currency manipulation. Thus, though not the ideal remedy, the Declaration does provide sufficient scope for initiating the process of addressing the issue in a much more focused and institutional manner. More importantly, it has brought the issue of currency manipulation into the domain of international trade agreements. It is seen as an "early warning system" via enhanced reporting requirements and frequent monitoring and consultations to deter currency manipulations as against strong, enforceable rules forbidding currency manipulation.

c. US domestic law and currency manipulation

The Joint Declaration of the TPP relating to currency exchange rates is seen as the first step in U.S. domestic circles along with US legislation to tackle the issue of currency manipulation. In 2015, the United States Trade Facilitation and Trade Enforcement Act 2015 was enacted which, inter alia, consisted of provisions relating to the enhancement of engagement of currency exchange rate and economic policies with certain major trading partners of the United States.

The statute mandates a report to be submitted to the Congress every six months consisting of the macroeconomic and currency exchange rate policies of each country that is a major trading partner of the United States. The report would contain that country's bilateral trade balance with the United States, that country's current account balance as a percentage of its gross domestic product, the change in that country's current account balance as a percentage of its gross domestic product during the 3-year period preceding the submission of the report, that country's foreign exchange reserves

[44] http://www.iie.com/publications/briefings/piieb16-4.pdf

as a percentage of its short-term debt and that country's foreign exchange reserves as a percentage of its gross domestic product.

Further, the report would also contain an *enhanced analysis* of macroeconomic and exchange rate policies for each country that is a major trading partner of the United States that has a significant bilateral trade surplus with the United States, a material current account surplus and engaged in persistent one-sided intervention in the foreign exchange markets.

An enhanced analysis of a country includes a description of developments in the currency markets of that country including currency interventions, a description of trends in the real effective exchange rate of the currency of that country and in the degree of undervaluation of that currency, an analysis of changes in the capital controls and trade restrictions of that country and the patterns in the reserve accumulation of that country.

The inclusion of an enhanced analysis of a country in the report would result in enhanced bilateral engagement with that country in order to urge implementation of policies to address the causes of the undervaluation of its currency, its significant bilateral trade surplus and its material current account surplus. The legislation further states that the bilateral engagement would express the concern of the United States with respect to the adverse trade and economic effects of undervaluation and advise that country of the ability of the United States of take remedial action under the Statute. It also envisions developing a plan with specific actions to address that undervaluation and surpluses.

If no corrective action to address the undervaluation is undertaken by the country whose enhanced analysis has taken place within one year of the bilateral engagement with the United States, the President is authorized to take one or more of the following actions – a) prohibit the Overseas Private Investment Corporation from approving any new financing with respect to a project located in that country on and after such date, b) pursuant to internal consultations and United States obligations under international agreements, prohibit the Federal Government from procuring or enter into any contract for the procurement of, goods or services from that country on and after such date, c) instruct the United States Executive Director of the IMF to call for additional rigorous surveillance of the macroeconomic and exchange rate policies of that country and also formal consultations on findings of currency manipulation and also ins and d) instruct the USTR to take into account in assessing whether to enter into a bilateral or regional trade agreement with that country or to initiate or participate in such negotiations, the extent to which that country has failed to adopt appropriate policies to correct undervaluation and surpluses.

Thus, the US law envisages a reporting system, coupled with enhanced analysis of countries that are alleged manipulators and then a process of bilateral engagement to redress the issue. The bilateral engagement is followed by remedial action where appropriate measures are not taken by the country to redress undervaluation. Thus, the TPP and the US law it is argued by some is a substantial progress on the issue of currency manipulation.

Nevertheless, contrary to the vision that the votaries of strong, enforceable rules for exchange rate manipulations in the TPP chapter that in hindsight was over-ambitious, the Declaration can be viewed as a soft landing in a comfort zone that will initiate the discussion on this complex issue in the international trade policy sphere.

IV. **What next? What should WTO Members look forward to?**

The inclusion of provisions relating to currency undervaluation, even though unenforceable, in the TPP has raised a number of questions in the context of currency manipulation and trade policy. This is the first trade agreement that indirectly refers to this issue, albeit in a soft "Declaration". Would other bilateral and plurilateral trade agreements see a similar trend in the future? Would soft law approaches replace hard law imperatives in this arena? Is there a realisation dawning that currency manipulation is too complex and multidimensional an issue that can be addressed in trade agreements? Has pragmatic trade negotiating strategy triumphed hard-held beliefs of the need for strong disciplines for competitive devaluation?

The threat of a possible WTO dispute on currency loomed large when the issue was at its peak a few years ago. However, the likelihood of that seems less likely now. For one, the United States seems to have adopted a more long-term institutional approach to addressing the problem with a set of unilateral measures (akin to its Special 301 process). It also has envisaged a greater role for its macroeconomic authorities to engage with other trading partner authorities to sort this issue rather than treating is a purely trade matter requiring an enforcement of rights and obligations under the GATT or the ASCM. The success of the TPP Group, the faithful adherence to the transparency requirements under the Declaration the impact of the Group's engagement as well as the effectiveness of the enhanced analysis under the US law will probably provide some answers as to how this discourse will go in the coming years. Nevertheless, the TPP Members are but a small subset of WTO Members and the standards would not apply to them. How the US will pursue the issue under the new legislation would to a large extent determine the impact of this issue on non-TPP members.

The need for new rules of the game for both currency manipulation as well domestic macroeconomic actions that impact on the competitive advantage by lowering the value of one's currency is a contentious one. The WTO is unlikely to be the forum for the initiation of such a dialogue. Could other groupings like the G20 become a forum for such discussions and brainstorming before a structure and fora emerges for housing these new set of rules. What impact would such discussion have on rule-making in the WTO as well as other mega-regional agreement negotiations. Further, would a more "best endeavour" regulatory co-operation approach between central bankers be more conducive to address the complexities and sensitivities of the issues involved. WTO members may have to become increasingly aware of this discourse since it may also be addressed in a mega-regional they are or will be eventually a part of.

The issue of currency manipulation is a complex one and is multi-dimensional not only in the international context but also in terms of the domestic players involved. An understanding of the issue and evolving of a national strategy would require, at a minimum, a multi-agency approach, beyond turf specificities with inter-disciplinary teams of economists, lawyers and policy makers.

Currency manipulation and trade policy has for the moment found a cosy balance in an unenforceable mechanism in a mega-regional trade pact highlighting the complexity of the issues involved. However, whether this would remain the standard in international negotiations or would take a different form also tackling macroeconomic decision making affecting the value of the currency is anyone's guess. Till then, the underlying tension in macroeconomic policy circles would be the eternal question of whether to manipulate or not. It is often argued that macroeconomic policy making is an issue of domestic sovereignty in policy making and international trade rules do not have a role. However, one has seen that in many areas of domestic policy making has not necessarily excludedits scrutiny in the international trade regime. Only time will tell if monetary policy is an exception to this trend.