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China's Foreign Exchange Policy: Global Effects and United States Policy Options

Brian Tribuna

“China’s unfair currency policies have cost millions of Americans their jobs, and I believe inaction on this issue is dangerous to our economic recovery and continues to put at risk hundreds of thousands of additional American jobs. When I travel around my district, I hear from small businesses and manufacturers on this issue. And they never ask for Congress to guarantee their success. All they want is a fair fight, for the rules to be the same. And I believe given a level playing field, American businesses will win every single time.”¹

China’s currency and exchange rate policy is the focus of much political rhetoric in the United States. Many politicians and economists argue that China is keeping the renminbi (RMB) artificially undervalued, which in turn gives them an unfair advantage in international trade at the expense of United States manufacturers and workers. As displayed by Congressman Donnelly in the above quote, many in the political arena blame China’s exchange rate policy for a multitude of problems facing the United States economy. Fresh off a presidential election, both candidates made it clear that they were going to “get tough” on China. Republican nominee Mitt Romney went as far as declaring “I will label China as it is, a currency manipulator. And they will recognize that if they cheat, there is a price to pay.”² President Obama has also been quoted as saying that “China’s trade surplus is directly related to its *manipulation* of its currency’s value.”³ Others are not so sure that the problem is as serious and clear-cut. John Frisbie, the President of the U.S.-China Business Council, recognized that “[b]oth presidential candidates have said they will ‘get tough’ on China, but evidence has shown that the best way to make

¹ 157 CONG. REC. H6863-01 (Oct. 13, 2011) (statement of Donnelly) (West)

² *Romney on China*, 2012 REPUBLICAN CANDIDATES (Apr. 12, 2013, 2:03 PM), <http://2012.republican-candidates.org/Romney/China.php>

³ Robert W. Staiger & Alan O. Sykes, *Currency “manipulation” and world trade: A caution*, VOXEU (Jan. 30, 2009), <http://www.voxeu.org/article/currency-manipulation-and-world-trade-three-reasons-caution>

progress is through comprehensive engagement – not political rhetoric.”⁴ James Dorn, a China specialist at the Cato Institute, warns that “[b]laming China for our woes is politically attractive but dangerous.”⁵ Instead of rash, politically charged, unilateral action by the United States against China to combat this perceived unfair economic imbalance, the United States should take a balanced, cautious, and collaborative effort to promote the economic and political interests of both countries.

Part I of this paper will start with an overview of international monetary systems throughout history and then focus on China’s exchange rate policy, covering its evolution over the past several decades to its current state, its technical application in the context of the international monetary system, allegations that the Chinese government is artificially keeping the RMB undervalued. Next this section will take a comparative look at the macroeconomic strategies employed by the United States and China to gain a better understanding of why China’s exchange rate policy has become such a hot button political issue in the United States. Part II of this paper will examine unilateral policy options being considered by the United States to counter this perceived unfair trade practice by China. Most of these options seem to be politically charged rather than based in sound political and diplomatic strategy, and this section will explore why such actions would most likely turn out to not only be ineffective, but dangerous and detrimental to United States economic relationships. Part III will look at the potential for a balanced, collaborative, multilateral approach at the international level. These options include employing international economic organizations such as the World Trade Organization (WTO) or International Monetary Fund (IMF) and global economic forums such as the Group of Twenty (G-20). The paper will conclude with a recommended course of action for

⁴ James A. Dorn, *China and the Truth about the Senate’s Exchange Rate Oversight Act*, CATO INSTITUTE (Oct. 4, 2011) <http://www.cato.org/publications/commentary/china-truth-about-senates-exchange-rate-oversight-act>

⁵ *Id.*

the United States and the rest of the international economic community that focuses on collaboration and formation of symbiotic relationships instead of specific targeted attacks that could have serious negative consequences worldwide. International monetary policy, and the United States-China economic relationship in particular, is a highly complex and politically sensitive issue that needs to be approached in a manner that will promote global prosperity while simultaneously avoiding another catastrophic international financial crisis.

International Monetary Policies

The bulk of China's most substantial monetary policy reform has occurred since the founding of the People's Republic of China (PRC) in 1949. A brief history of international monetary systems alongside China's own reforms will be helpful in understanding the context of the current issues.

History of International Monetary Systems

The last two centuries have witnessed dramatic changes to international monetary systems. Prior to World War I, global currencies generally followed a gold or silver standard⁶, where each nation's currency was backed by and freely convertible into the precious metal pledged behind it.⁷ Following turbulent economic times, marked by two World Wars and the Great Depression, leaders from the Allied Nations met in Bretton Woods, New Hampshire, to craft an international monetary system that would "combine the advantage of the classical gold standard (i.e. exchange rate stability) with the advantage of floating rates (i.e. independence to

⁶ Justin Yifu Lin et al., *Reform of the International Monetary System: A Jagged History and Uncertain Prospects*, (The World Bank, Policy Research Working Paper No. 6070, May 2012). While most nations during the period followed the gold standard, some, including China, followed the silver standard.

⁷ *Id.*

pursue national full employment policies).”⁸ The Bretton Woods regime fixed foreign currencies against the United States dollar, and the United States dollar was fixed at \$35 per ounce of gold.⁹ “Member countries could hold their official reserves mainly in the form of gold or dollar-denominated assets and had the right to sell their dollars to the US Federal Reserve in exchange for gold at the official price.”¹⁰ Another important aspect of the Bretton Woods meetings was the establishment of the [IMF](#)¹¹, whose responsibilities has greatly evolved since and are explored in greater depth in Part III on this paper. Even though exchange rates were fixed to the U.S. dollar, these rates were subject to change given they met a certain set of requirements as determined by the IMF.¹²

A series of issues with the Bretton Woods system, including United States macroeconomic policies and increased spending during the Vietnam War, led President Nixon to officially end convertibility of the [U.S.](#) Dollar to gold.¹³ These actions set the groundwork for the prevailing international monetary system observed today, where most major currencies are in a free float against each other based on global market supply and demand, subject to certain limitations.¹⁴

History of China’s Monetary System

⁸ MICHAEL D. BORDO & BARRY EICHENGREEN, *The Bretton Woods International Monetary System: A Historical Overview*, in A RETROSPECTIVE ON THE BRETTON WOODS SYSTEM: LESSONS FOR INTERNATIONAL MONETARY REFORM, (University of Chicago Press, Jan. 1993) (available at <http://www.nber.org/chapters/c6867.pdf>).

⁹ Lin, *supra* note 6.

¹⁰ Lin, *supra* note 6.

¹¹ The main purpose of the World Bank was to “help [integrate](#) the less-developed economies into the world economy... through a combination of advice, direct loans, and guarantees of third party loans.” Philip O’Hara, *Bretton Woods System and the Post Bretton Woods System*, THE ENCYCLOPEDIA OF POLITICAL ECONOMY (available at <http://www.econ.tcu.edu/harvey/5133/bretton.html>)

¹² Lin, *supra* note 6.

¹³ Richard Nixon, President of United States, Address to the Nation Outlining a New Economic Policy: “The Challenge of Peace.”, (Aug. 15, 1974) (transcript available at <http://www.presidency.ucsb.edu/ws/?pid=3115>) Nixon also announced in his speech a ten percent tariff on all goods imported to the United States and a temporary freeze on wages and prices of goods to combat potential inflationary effects of the suspension.

¹⁴ O’Hara, *supra* note 11.

When the PRC was founded in 1949, the “new central government unified the banking system by establishing a national bank, the People’s Bank of China (PBOC), and a national currency” called the renminbi (translated literally at the “people’s money”).¹⁵ The two major policies embraced by the PBOC in the early years of the PRC included “forbidding circulation of foreign currencies within China and... providing for state supervision over all inflows and outflows of foreign exchange.”¹⁶ This regime, which contributed to low levels of foreign direct investment, was largely held in place through the late 1970s, when Deng Xiaoping took his place as the paramount leader of China and started liberalizing trade and economic policies.¹⁷

Throughout the 1980s and into the mid 1990s China employed a dual exchange rate system, which was composed of an “official fixed exchange rate system,” used by the government, and another system used as the official avenue for importers and exporters to gain access to RMB conversion through swap markets in which the rate was relatively market-based.¹⁸ This created a lucrative black market for foreign exchange, sometimes referred to as a *third* exchange system, because there was a large discrepancy in the rate between the two markets.¹⁹ In 1993 the official government rate for RMB-dollar conversion set at 5.77 yuan versus 7.70 yuan in the swap markets.²⁰

In 1994 the Chinese government merged the dual exchange system and pegged the RMB-dollar conversion rate at 8.70 yuan.²¹ This new system is best categorized as a “market-based managed float system,” where the central bank initially maintained the stated 8.70 rate, but

¹⁵ Larry L. Drumm, *Changing Money: Foreign Exchange Reform in the People's Republic of China*, 18 *Hastings Int'l & Comp. L. Rev.* 359, 362 (1995).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS21625, CHINA’S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES (2011)

¹⁹ Larry Drumm article

²⁰ MORRISON, *supra* note 18.

²¹ Bryan Mercurio & Celine Sze Ning Leung, *Is China a “Currency Manipulator”?: The Legitimacy of China’s Exchange Regime Under the Current International Legal Framework*, 43 *Int’l Law.* 1257, 1261 (2009).

allowed intraday rates to float by 0.3% among banks trading the RMB.²² Eventually in 1997, the official stated rate was allowed to increase to 8.28 yuan.²³ China was able to maintain this dollar peg by “buying (or selling) as many dollar denominated assets in exchange for newly printed yuan as needed to eliminate excess demand (supply) for the yuan.”²⁴ This regime, which is the same method used to maintain the RMB’s current valuation, effectively counters market forces that determine exchange rates of other major currencies that are traded on a free-floating market. China justified this regime, as they similarly do today, by stating that it was intended to promote economic stability and encourage foreign investment during periods of rapid growth while the nation’s economy was still in developing stages.²⁵

In 2005, China further liberalized their monetary policy by instituting another 2.1% appreciation and pegging the yuan to a basket of currencies, rather than the dollar alone.²⁶ The daily intraday trading range was also increased from 0.3% to 0.5% against this new basket of currencies. Since 2005, China has continued, albeit at what many consider too slow of a pace, to gradually implement policies that have lead to an appreciation of the RMB. There was a temporary suspension of RMB appreciation during the global financial crisis, where the RMB was again pegged at a fixed rate to the U.S. Dollar, partly in response to a decreased demand for Chinese exports.²⁷ Since RMB appreciation resumed [in](#) June 2010, China has committed to

²² *Id.*

²³ MORRISON, *supra* note 18.

²⁴ *Id.*

²⁵ *Id.*

²⁶ Mercurio, *supra* note 21, at 1261. While the precise composition of this currency basket has never been disclosed, China has stated that it is linked primarily to the dollar, euro, yen, and a few other major currencies. Economic indicators however show that the exchange rate is still highly responsive to movement of the dollar, so it is very likely the basket is heavily weighted towards the dollar.

²⁷ See MORRISON, *supra* note 18, “China halted its currency appreciation policy around mid-July 2008, mainly because of declining global demand for Chinese products that resulted from the effects of the global financial crisis. In 2009, Chinese exports and imports fell by 15.9% and 11.3% over 2008 levels. The Chinese government reported that thousands of export-oriented factories were shut down and that over 20 million migrant workers lost their jobs in 2009 because of the direct effects of the global economic slowdown. The RMB/dollar exchange was held relatively constant at 6.83 through around mid-June 2010.”

“proceed further with reform of the RMB exchange rate regime and to enhance RMB exchange rate flexibility.”²⁸ As of April 8, 2013, the United States dollar to Chinese RMB exchange rate was trading at approximately 6.20 yuan, with a daily float allowance of 1.0%.²⁹

Comparative Look at Monetary Policy Management

Exchange rate management is one cog in a much larger wheel of a nation’s broader economic goals. Most of world’s major economies participate in certain actions to further these objectives, and a comparative look between the two largest³⁰ (the United States and China) will demonstrate how China’s exchange rate management should be viewed at the international level.

Quantitative Easing in the United States

The financial crisis in 2008 was one of the worst catastrophes to hit the international economy since the Great Depression. In order to counter widespread distrust in the financial industry, inject liquidity into the markets, and restore order among global financial institutions, the Federal Reserve started engaging in what is defined as “quantitative easing.”³¹ Quantitative easing is a type of monetary policy where newly printed currency is used to purchase assets such as Treasury Securities in order to promote economic stability and keep interest rates low.³² In a statement from the Federal Reserve in January of 2013, the Federal Open Market Committee justified such practice by stating it was “firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term

²⁸ *Id.*

²⁹ XE: THE WORLD’S FAVORITE CURRENCY SITE, <http://www.xe.com/currencyconverter/convert/?Amount=1&From=USD&To=CNY> (last visited April 22, 2013).

³⁰ World’s largest economies as measured by 2012 Nominal GDP: United States at \$15.7 trillion, China at \$8.2 trillion. *World Economic Outlook: Hopes, Risks, Realities*, INTERNATIONAL MONETARY FUND, available at <http://www.imf.org/external/pubs/ft/weo/2013/01/pdf/text.pdf> (retrieved April 16, 2013).

³¹ Andrew Bowman et al., *Central Bank-Led Capitalism?*, 36 SEATTLE U. L. REV. 455, 468 (2013).

³² *Id.*

interest rates.”³³ This strategy was particularly important in 2008, when the Federal Reserve printed U.S. Dollars to purchase troubled assets from mortgage lenders Freddie Mae and Fannie Mae to help curb the effects of the housing bubble collapse.³⁴

In practice, quantitative easing boils down to printing more money and lending it to banks at near zero-interest rates, in an effort to increase lending and stimulate the economy.³⁵ These efforts have not been without widespread criticism from the international community. As the United States simultaneously criticized China for keeping the RMB below market rates, it was flooding the capital markets with an increased supply of dollars. Xia Bin, an adviser to the central bank of China, stated that as “long as the world exercises no restraint in issuing global currencies such as the dollar – and this is not easy – then the occurrence of another crisis is inevitable.”³⁶ Notable economists and finance ministers from Thailand, Hong Kong, and the Eurozone have also expressed concern and caution over the use of continued quantitative easing in the United States.³⁷

Throwing non-protectionist political rhetoric at a monetary policy such as quantitative easing, a popular strategy among its proponents in the United States, does not lessen the artificial effects it has on the global economy. Stripping away United States political rhetoric and

³³ *Statement on Longer-Run Goals and Monetary Policy Strategy*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, (as effective Jan. 29, 2013) available at http://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf.

³⁴ See generally Mark Sunshine, *Experts Agree The Fed's in Big Trouble*, FORBES, (Apr. 23, 2013).

³⁵ Larry Elliot, *Quantitative Easing*, GUARDIAN (Jan 8, 2009), available at <http://www.guardian.co.uk/business/2008/oct/14/businessglossary>.

³⁶ Bettina Wassener, *Emerging-Market Countries Criticize Fed Decision*, N.Y. TIMES, Nov. 4, 2010, available at http://www.nytimes.com/2010/11/05/business/global/05global.html?_r=0.

³⁷ *Id.* “In Thailand, Finance Minister Korn Chatikavanij said the central bank governor had ‘confirmed discussions with central banks of neighboring countries, which are ready to impose measures together, if needed, to curb possible speculative money flowing into the region,’ according to Reuters. Norman Chan, chief executive of the Hong Kong Monetary Authority, warned that the Fed’s new measures — informally known as QE2, denoting the second round of what is called quantitative easing — added to the risk of asset bubbles, including a bubble in the city’s housing sector. ‘For emerging markets, QE2 means a guarantee of the ‘low for longer’ scenario through the first half of 2011, which suggests inflows into emerging markets will continue, if not strengthen,’ Richard Yetsenga and Pablo Goldberg, analysts at HSBC, said in a note on Thursday. ‘The tide generated by the liquidity from abroad is bigger than whatever wall emerging market countries can put up.’”

justifications from Ben Bernanke does not detract from the fact that the Federal Reserve is actively distorting the international economic environment. By guaranteeing the purchase of Treasury Securities and injecting more capital into the markets, everything from the true value of the dollar, commodity prices, and global interest rates are going to deviate from what they would be under a true market-based system free from governmental intervention.³⁸ So how does this differ from China's perceived "currency manipulation?" Interestingly, a report came out in April 2013 that a woman in the Kunming Province in China filed a lawsuit against the United States for devaluing her United States Dollar holdings, \$250, through the use of quantitative easing.³⁹ Though she is only seeking \$1 in damages, and a "promise from the U.S. central bank to stop abusing its 'monopoly' over currency creation,"⁴⁰ it is interesting to see that the rest of the world has taken notice and noted frustration over the potentially hypocritical monetary policies being embraced in the United States. The next section explores the policies and actions taken by the Chinese government used to keep its exchange rate within its stated target.

Exchange Rate Management in China

There are two primary methods that China uses to keep the exchange rate within the stated target and 1.0% trading band. The first is active participation in foreign exchange markets: "[A]t the first sign of an appreciating RMB, the Chinese government respond[s] by increasing the supply of RMB and decreasing the supply of another nation's currency by purchasing that nation's currency on the currency market, thus restoring the desired equilibrium."⁴¹ This method in particular has led to China's massive accumulation of dollar

³⁸ *Id.*

³⁹ Michael Kitchen, *Chinese women reportedly wants to sue Federal Reserve over QE*, MARKETWATCH, (April 15, 2013) <http://blogs.marketwatch.com/thetell/2013/04/15/china-woman-reportedly-wants-to-sue-federal-reserve-over-qe/>.

⁴⁰ *Id.*

⁴¹ Paul V. Sharobeem, *Biting the Hand That Feeds Us: A Critical Analysis of U.S. Policy Trends Concerning Chinese Currency Manipulation*, 19 FLA. J. INT'L L. 697, 698 (2007)

denominated securities, specifically United States Treasury bonds. Instead of holding actual dollars in their foreign reserve, which are likely only to decrease in value over time due to inflation and the time value of money, the Chinese government invests these accumulated dollars in (nearly) risk-free United States Treasury securities.⁴² As of December 2012, China held more than \$3.3 trillion in foreign currency reserves,⁴³ and more than \$1.2 trillion in U.S. Treasury Securities.⁴⁴

The second method China employs when trying to maintain the target exchange rate is strict capital controls. For example “the Chinese government required firms in China to exchange most of their hard currency earnings to the central government in exchange for RMB. While the Chinese government did eventually [post-merger of the dual exchange system] allow the RMB to be free convertible ‘for purposes of trade in goods and services,’ capital transactions remained subject to strict controls to curtail unpredictable flows of capital into or out of the country. This meant while the RMB was convertible for trade transactions, it was still not freely convertible for other types of financial flows such as portfolio investments.”⁴⁵ As explained in Part III, however, in recent years China has been implementing reforms to loosen these capital restrictions and encourage foreign investment in mainland China.

The Chinese government defends these actions by claiming a carefully managed RMB is important to maintain economic stability, not to gain an unfair advantage in trade.⁴⁶ They further claim that abandoning their current currency policy could lead to wide-scale layoffs, particularly

⁴² Paul V. Sharobeem, *Biting the Hand that Feeds Us: A Critical Analysis of U.S. Policy Trends Concerning Chinese Currency Manipulation*, 19 Fla. J. Int'l L. 697 (2007) at 700.

⁴³ U.S. Dep't of the Treasury, Office of Int'l Affairs, Report to Cong. On Int'l Econ. and Exch. Rate Policies (April 12, 2013) available at <http://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/Foreign%20Exchange%20Report%20April%202013.pdf>.

⁴⁴ *Major Foreign Holders of Treasury Securities*, U.S. DEPARTMENT OF THE TREASURY, available at [http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh\(shl2012\).txt](http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh(shl2012).txt).

⁴⁵ Sharobeem, *supra* note 42, at 698-99.

⁴⁶ WAYNE M. MORRISON, CONG. RESEARCH SERV., RL33536, China-U.S. Trade Issues (2012).

in the fragile manufacturing sector, and thereby lead to political unrest and threaten national stability.⁴⁷ Another concern is the underdeveloped banking system in China that could be very vulnerable to a rapid and drastic shift in the exchange rate policy.⁴⁸ The banking sector's intimate relationship with state owned enterprises, coupled with a shock of speculative pressures likely to stem from an immediately floating exchange rate could plunge the banking sector in China into a financial crisis.⁴⁹

Determining the Value of the RMB

There are a number of economic measures and indicators that can assist in determining whether, and to what extent, a country's currency is overvalued or undervalued. Two major measures looked at by economists when determining the level of intervention and misalignment are the current account surplus and foreign reserve accumulation.⁵⁰ A current account surplus is a situation where there exists an "imbalance in a nation's balance of payments current account in which payments received by the country for selling domestic exports are greater than payments made by the country for purchasing imports."⁵¹ When the surplus is significant, it implies that export growth is substantially more significant than import growth, which is an economic effect of having an undervalued currency. In 2007, China's current account surplus reached a peak of 10.1% of its GDP.⁵² However, as a result of lower international demand for Chinese exports during the financial crisis and a broader economic downturn, China's current account surplus fell to 2.3% of GDP in 2012.⁵³ This drastic decrease, though still substantial relative to other countries, shows there seems to be a gradual rebalancing of the Chinese economy and is contrary

⁴⁷ *Id.*

⁴⁸ Sharobeem, *supra* note 42, at 707-708.

⁴⁹ *Id.*

⁵⁰ Report to Cong. On Int'l Econ. and Exch. Rate Policies, *supra* note 43.

⁵¹ *Definition of current account surplus*, ECONOMIC GLOSSARY, <http://glossary.econguru.com/economic-term/current+account+surplus> (last visited Apr. 28, 2013).

⁵² Report to Cong. On Int'l Econ. and Exch. Rate Policies, *supra* note 43.

⁵³ *Id.*

to many claims that China is manipulating its currency specifically in an effort to gain an unfair advantage in trade.

Another measure that indicates active participation in exchange rate misalignment is a country's accumulation of foreign reserves. Foreign reserve accumulation is the direct result of a central bank's active participation in foreign exchange markets, a practice the PBOC utilizes when maintaining the exchange rate within its prescribed 1.0% daily trading band and target exchange rate.⁵⁴ While China's accumulation of foreign reserves slowed to \$21.3 billion per quarter in the first three quarters of 2012, the first quarter of 2013 showed a record purchase of \$109.9 billion in foreign exchange by the PBOC and other financial institutions in China.⁵⁵ These numbers, however, are based on estimates because China does not specifically disclose its data on foreign exchange market activity.⁵⁶ Also, although China is an active member of the IMF, they do not subscribe to the Special Data Dissemination Standard⁵⁷ on reserve transparency nor do they report to the IMF's Composition of Official Exchange Reserves Database.⁵⁸ Failure to report this crucial and specific data leads to further valuation difficulties when attempting to determine what an actual market-based exchange rate would be for China.

So comes the million-dollar (or, RMB 6,165,000.06⁵⁹) question: to what extent is the RMB undervalued? Economists across the world have come up with estimates over the past decade that vary wildly. In the IMF's July 2012 Pilot External Sector Report it stated that the RMB was "moderately" undervalued, between 5.0% to 10.0%, against a broad basket of

⁵⁴ See Part I, section on mechanics of China's mechanics of exchange rate management.

⁵⁵ Report to Cong. On Int'l Econ. and Exch. Rate Policies, *supra* note 43.

⁵⁶ *Id.*

⁵⁷ *Factsheet - IMF Standards for Data Dissemination*, INTERNATIONAL MONETARY FUND, <http://www.imf.org/external/np/exr/facts/data.htm>, (last visited Apr. 29, 2013).

⁵⁸ *Currency Composition of Official Foreign Exchange Reserves*, INTERNATIONAL MONETARY FUND, <http://www.imf.org/external/np/sta/cofer/eng/>, (last visited Apr. 29, 2013). "Data dissemination standards are important because they help enhance the availability of timely and comprehensive statistics, which contributes to the pursuit of sound macroeconomic policies and efficient functioning of financial markets."

⁵⁹ Based on a \$1/RMB 6.17 exchange rate as cited by google.com on May 1, 2013.

currencies.⁶⁰ In 2012, Fred Bergstein recommended during testimony before the U.S. House of Representatives Committee of Ways and Means that over the next three years China should let its exchange rate appreciate by 20.0% to 25.0%.⁶¹ Other estimates over the past decade include a 12.0% to 50.0% range,⁶² 40%,⁶³ and a more modest 15.0 to 20.0% range.⁶⁴ These estimates prove one thing for certain: while it is generally agreed in the international economic community that RMB exchange rate is held below what a natural market level would be, there is no consensus on the actual valuation. Nevertheless, politicians in the United States are still calling for unilateral action against China to combat these perceived unfair policies.

Potential Unilateral Policy Options for the United States

One of the most commonly advocated courses of action for the United States to respond to China's perceived currency manipulation is to treat it as an unfair trade practice under United States trade law. This section will give an overview of existing trade law, including the Tariff Act of 1930⁶⁵ and its countervailing duty and antidumping provisions, and the role of the Commerce department in resolving trade disputes. Next this section will explore United States legislative options that look to amend existing trade law, specifically the Currency Reform for Fair Trade Act and the Currency Exchange Oversight Reform Act, and the inherent problems

⁶⁰ *Pilot External Sector Report: July 2, 2012*, INTERNATIONAL MONETARY FUND, available at <http://www.imf.org/external/np/pp/eng/2012/070212.pdf>.

⁶¹ C. Fred Bergstein, Director, Peterson Institute for International Economics, Testimony before the Hearing on China's Exchange Rate Policy, Committee on Ways and Means, US House of Representatives (September 15, 2010).

⁶² Dorn, *supra* note 4.

⁶³ Paul Eckert, *Senate Approves China Yuan Bill, House Fate Unclear*, REUTERS, (Oct. 11, 2011) available at <http://www.reuters.com/article/2011/10/11/us-usa-china-idUSTRE79A5A020111011>

⁶⁴ David E. Sanger & Michael Wines, *More Countries Adopt China's Tactics on Currency*, N.Y. TIMES, (Oct. 3, 2010) available at <http://www.nytimes.com/2010/10/04/world/04currency.html>

⁶⁵ 19 U.S.C. § 1202, *et. seq.*(West)

with both of these acts. Aside from these two main bills, a handful of other legislative options have been explored in Congress, and a brief explanation (alongside why they ultimately failed) will help illustrate the mindset of politicians in the United States as they advocate these bills. This section will then explore the power of the Treasury Department, and the affirmative duties it has under the Omnibus Trade and Competitiveness Act of 1988⁶⁶ in identifying countries it deems to be currency manipulators.

United States Legislative Approaches by Amending Existing Trade Law

Overview of Existing United States Trade Law

Since its adoption, the Tariff Act of 1930 has provided the legal basis for the United States to counter unfair practices in international trade.⁶⁷ The countervailing duty and antidumping provisions in the Tariff Act of 1930 are two major avenues used in the United States to combat unfair international trade practices. Countervailing duties are imposed when it is determined “that the government of a country or any public entity within the territory of a country is providing, directly or indirectly, a countervailable subsidy with respect to the manufacture, production, or export of a class or kind of merchandise imported, or sold (or likely to be sold) for importation, into the United States.”⁶⁸ Countervailing duties deal directly with foreign government action in subsidizing their domestic industries. The purpose, therefore, of the United States in trying to counter these duties is to create equilibrium in international trade by offsetting the unfair advantage gained by a foreign exporter to the United States through governmental subsidization.⁶⁹

⁶⁶ Pub. L. 100-418, Aug. 23, 1988, 102 Stat. 1107 (West)

⁶⁷ Sharobeem, *supra* note 42, at 713.

⁶⁸ 19 U.S.C.A. § 1671(a)(1) (2012) (West)

⁶⁹ *Royal Thai Gov't v. United States*, 502 F.Supp.2d 1334, 1340 (Ct. Int'l Trade 2007).

Antidumping laws, on the other hand, focus on private actors and determine “whether subject merchandise is being, or is likely to be, sold at less than fair value” in the United States marketplace.⁷⁰ Domestic competitors are thereby injured “when a company exports to the United States at prices that are less than the normal value of its products.”⁷¹ Antidumping laws seek to protect these domestic producers of goods who manufacture products similar to those that are being sold by foreign exporters at injuriously low prices. “The central aim of the antidumping laws is to protect domestic industries from foreign manufactured goods that are sold injuriously in the United States at prices below the fair market value of those goods in their home market.”⁷²

Though countervailing duty and antidumping laws deal with problems that have different origins (i.e. government for countervailing duties and exporters for antidumping), investigations and enforcement action are largely parallel. The first step for an “interested party”⁷³ to initiate either an antidumping or countervailing duty investigation is to file a petition with an “administering authority.”⁷⁴ The United States Department of Commerce (DOC) and the United States International Trade Commission (ITC) then share responsibilities in both of these proceedings, which include investigating whether an injury has occurred and the extent of that injury with respect to domestic producers.⁷⁵

There is one case, *Nucor Fastener Div. v. United States*,⁷⁶ where a United States producer of steel fasteners filed suit under current law challenging Commerce’s decision not to conduct a countervailing duty investigation of alleged Chinese subsidization through currency

⁷⁰ 19 U.S.C.A. § 1677(b) (2012) (West).

⁷¹ International Trade Practice, A.L.R. § 15:1.

⁷² *U.S. Steel v. United States*, 637 F.Supp.2d 1199, 1204 (Ct. Int’l Trade 2009).

⁷³ As defined under 19 U.S.C.A. § 1677(9)(C)-(G) (West).

⁷⁴ Defined under 19 U.S.C.A. § 1677(1) as “The term “administering authority” means the Secretary of Commerce, or any other officer of the United States to whom the responsibility for carrying out the duties of the administering authority under this subtitle are transferred by law.

⁷⁵ Sharobeem, *supra* note 42, at 713.

⁷⁶ *Nucor Fastener*, 751 F.Supp.2d at 1327.

manipulation. Though Commerce conducted a countervailing duty investigation against China, and in fact included twenty-six specific instances where Nucor alleged countervailable subsidies, it declined to investigate the alleged currency manipulation as a subsidy issue.⁷⁷ Commerce stated in its investigation:

“[Nucor] alleges that the [government]-maintained exchange rate effectively prevents the appreciation of the Chinese currency (“RMB”) against the U.S. dollar. Therefore, when producers/exporters in the PRC sell their dollars at official foreign exchange banks, as required by law, the producers receive more RMB than they otherwise would if the value of the RMB were set by market mechanisms.... [Nucor] has failed to sufficiently allege that the receipt of the excess RMB is contingent on export or export performance because receipt of the excess RMB is independent of the type of transaction or commercial activity for which dollars are converted or of the particular company or individuals converting the dollars. Therefore, we do not plan on investigating this program because [Nucor] has failed to properly allege the specificity element.”⁷⁸

It is important to note that Commerce declined to investigate due to a jurisdictional issue, and did not consider currency manipulation as an illegal subsidy on the merits. Nucor’s complaint was dismissed because their challenge against Commerce was unripe.⁷⁹ This case, however, sheds light on the legislation being considered by Congress, and raises the question of whether United States trade law is a reasonable and forum for consideration of alleged currency manipulation.

Currency Reform for Fair Trade Act

The Currency Reform for Fair Trade Act of 2013 was introduced and assigned to a congressional committee on March 20, 2013.⁸⁰ Its stated purpose is to “amend title VII of the Tariff Act of 1930 to clarify that countervailing duties may be imposed to address subsidies relating to a fundamentally undervalued currency of any foreign country.”⁸¹ Over the last number of congressional sessions, versions of this bill have been introduced in both the House and

⁷⁷ *Id.*, at 1330.

⁷⁸ *Id.*, at 1330, quoting *Certain Steel Fasteners from the People’s Republic of China: Initiation of Countervailing Duty Investigation*, 74 Fed. Reg. 54,543, 54,546 (October 22, 2009).

⁷⁹ *Id.*, at 1328.

⁸⁰ Currency Reform for Fair Trade Act of 2013, H.R. 1276, 113th Cong. (1st Sess. 2013).

⁸¹ *Id.*

Senate, and have garnered widespread bipartisan support.⁸² Though different versions of this bill have passed both the House and Senate, no version has been enacted to date.

All versions of this bill would “clarify” that a “fundamentally misaligned currency” could be considered an actionable subsidy by the DOC under existing countervailing duty laws.⁸³ This language implies that an undervalued currency acts as either a direct or indirect subsidy on foreign exporters, and the United States should be able to impose additional duties on these exports in order to prevent harm to domestic producers. First, the DOC would be required to determine whether a country’s currency is fundamentally undervalued by looking at a number of factors over a trailing 18-month period including active intervention in currency markets, at least a 5 percent undervalued real effective exchange rate, significant and persistent global current accounts surpluses, and the quantity of foreign asset reserves held by the foreign government.⁸⁴ The bill directs the DOC to determine the extent of a country’s currency undervaluation by using a number of different techniques depending on available data, including the valuation methodologies employed by the IMF Consultative Group on Exchange Rate Issues, “generally accepted economic and econometric techniques,” data from other international organizations or governments, or “inflation-adjusted, trade-weighted exchange rates.”⁸⁵ A similar bill has also been bouncing around United States politics in recent years, which goes beyond the scope of the Currency Reform for Fair Trade Act.

Currency Exchange Rate Oversight Reform Act

⁸² See Currency Reform for Fair Trade Act of 2011, H.R. 639, 112th Cong. (1st Sess. 2011); Currency Reform for Fair Trade Act of 2011, S. 328, 112th Cong. (1st Sess. 2011); Currency Reform for Fair Trade Act of 2010, H.R. 2378, 111th Cong. (2d Sess. 2010); Currency Reform for Fair Trade Act of 2009, S. 1027, 11th Cong. (1st Sess. 2009).

⁸³ Currency Reform for Fair Trade Act of 2013, H.R. 1276 § 2, 113th Cong. (1st Sess. 2013).

⁸⁴ Currency Reform for Fair Trade Act of 2013, H.R. 1276 § 2(c), 113th Cong. (1st Sess. 2013).

⁸⁵ Currency Reform for Fair Trade Act of 2013, H.R. 1276 § 2(d), 113th Cong. (1st Sess. 2013).

The Currency Exchange Rate Oversight Reform Act⁸⁶, which passed the Senate in 2011 but eventually died in the house, shares some similarities with the Currency Reform for Fair Trade Act. In addition to amending countervailing duty law to include currency manipulation as an actionable subsidy, as with the Currency Reform for Fair Trade Act, this bill imposes additional duties on the Treasury and DOC:

“The bill would require the Treasury Department to issue a semiannual report to Congress on international monetary policy and currency exchange rates, determine which major global currencies are in fundamental misalignment, and designate certain misaligned currencies for priority action. Treasury would be required to seek negotiations with countries designated for priority action. If efforts were not made to correct the currency misalignment, the following actions would be taken in regard to that country: (1) The Commerce Department would be required to factor in the estimated level of currency undervaluation when determining antidumping duties; (2) the President would be required to prohibit the procurement by the federal government of products and services from the country unless it is a party to the WTO’s GPA; (3) the Overseas Private Investment Corporation (OPIC) would not be able to approve any new financing with respect to a project located within the country; (4) the U.S. Executive Director at each multilateral bank would be told to oppose the approval of any new financing to the government of a country, or for a project located within a country, that issues a currency designated for priority action. If a country that has a currency designated for priority action failed to take steps to eliminate the fundamental misalignment within 360 days after its designation by the Treasury Department, the following would occur: (1) the USTR would be required to initiate a dispute resolution case against the priority country; (2) the Treasury Department would be required to consult with the Federal Reserve System to consider undertaking remedial intervention in international currency markets.”⁸⁷

This bill, clearly, is more far-reaching than the Currency Reform for Fair Trade Act, and if ever signed into law would be a serious shot across the bow of the Chinese government by compelling interagency actions by the United States government against China. This bill also mandates that currency undervaluation would need to be considered when calculating antidumping margins, further amending trade law into uncharted and potentially dangerous waters. There are similar arguments both in support and in criticism for this bill and the Currency Reform for Fair Trade Act.

⁸⁶ Currency Exchange Rate Oversight Reform Act of 2011, S. 1619, 112th Cong. (1st Sess. 2011).

⁸⁷ Morrison, *supra* note 46.

Advocates for these options contend that an undervalued RMB is having a hugely detrimental effect on the United States GDP and is a major contributing factor to job losses in the United States, specifically in the manufacturing sector. In a report from the House Ways and Means committee, the committee cites an estimate from Paul Krugman, a Nobel Prize winning economist, that the United States GDP is reduced by 1.4% annually as a direct result of an undervalued RMB.⁸⁸ Fred Bergstein, an economist at the Peterson Institute, is also referred to in the report in claiming that allowing the RMB to appreciate to a true market rate would create approximately 500,000 manufacturing jobs in the United States.⁸⁹ In testimony before the Committee on Ways and Means in 2010, Mr. Bergstein specifically claimed that “[u]nder current conditions of high unemployment, an improvement of \$50 billion to \$120 billion in the U.S. trade balance would generate 300,000 to 700,000 new U.S. jobs.”⁹⁰

There is also substantial opposition to these legislative options. In a letter to Congress, members of the business community expressed concern over such unilateral retaliatory measures. Authored by organizations including the U.S. Chamber of Commerce, the National Foreign Trade Council, and the U.S.-China Business Council, among others, the letter highlights many negative consequences such action could trigger.⁹¹ The broad message embodied by this letter is that the very complex U.S.-China economic relationship cannot be resolved through targeting a specific issue such as exchange rate management, and taking unilateral retaliatory action as suggested in this bill would compromise other aspects of the relationship including intellectual property rights, market access issues, and liberalization of the Chinese financial services

⁸⁸ Currency Reform for Fair Trade Act of 2010, H.R. 2378, 111th Cong. (Ways & Means Committee Report, 2010).

⁸⁹ *Id.*

⁹⁰ Bergstein, *supra* note 61.

⁹¹ Letter to Congress from U.S. Chamber of Commerce et al., (September 28, 2010) *available at* https://www.uschina.org/public/documents/2010/09/coalition_letter_amended_hr2378.pdf.

industry.⁹² They also express hesitation that the legislation would have its intended effect of forcing China to rapidly reform their exchange rate policy, but instead could spark a currency or trade war that would have near universal negative consequences across the world.⁹³

Other Unilateral Options for the United States

Countervailing Currency Intervention

Another option being considered by some commentators, and which is also part of the Currency Exchange Rate Oversight Reform Act of 2011, is countervailing currency intervention. Mr. Bergsten, mentioned above, suggests that when China (or other alleged currency manipulators, such as Japan) intervenes in the foreign exchange markets, the Treasury should sell an equivalent amount of U.S. dollars or dollar-denominated assets to counter the effects on the exchange rate.⁹⁴ There are, of course, technical problems involved when trying to actively intervene because the RMB is inconvertible for capital transactions. Mr. Bergsten suggests using proxies such as debt instruments and futures contracts through third-party intermediaries that would have the same constructive effect of a direct countervailing currency intervention.⁹⁵

Treasury Department

Twice a year, pursuant to the Omnibus Trade and Competitiveness Act of 1988, the Treasury Department is required to determine if any country is manipulating their currency to either gain an unfair advantage in trade or to prevent effective balance of payments adjustments.⁹⁶ If a country is deemed to be manipulating their currency for one of these reasons,

⁹² *Id.*

⁹³ *Id.*

⁹⁴ Fred Bergstein, *We can fight fire with fire on the renminbi*, FINANCIAL TIMES, October 3, 2010, <http://www.ft.com/intl/cms/s/0/070e525c-cf1d-11df-9be2-00144feab49a.html#axzz2RXzg9Mhd>.

⁹⁵ *Id.*

⁹⁶ WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RL32165, CHINA'S CURRENCY: ECONOMIC ISSUES AND OPTIONS FOR U.S. TRADE POLICY (2008).

the Treasury Department is thus compelled to initiate negotiations with the country, and if necessary, bring a complaint to an international economic organization.⁹⁷

The last time the Treasury Department labeled a country as a currency manipulator was July 1994, prior to China's major reforms as discussed in Part I, where it stated that "[b]ased on China's continued reliance on foreign exchange restrictions, it is Treasury's judgment that China manipulates its exchange system to prevent balance of payments adjustment and gain unfair advantage in trade."⁹⁸ Since 1994, however, the Treasury Department has not named any country as a currency manipulator for reasons of gaining an unfair advantage in trade or to prevent effective balance of payment adjustments.⁹⁹

Recommendations for the Unilateral United States Options

My first recommendation regarding unilateral United States option would be for Congress to abandon the idea of amending our existing trade law to include currency intervention as an actionable subsidy under either countervailing duty or antidumping law. Proponents of such legislation assure the bills are WTO-consistent, because the United States and other members of the WTO are within their rights to take remedial measures to counter unfair trade practices in the form of countervailable subsidies (which would include currency manipulation under the new bill). However, there is no precedent in the WTO of classifying a country's exchange rate policy as a form of countervailable subsidy. If the United States imposed additional duties on China based on an undervalued RMB, China has the power to bring action

⁹⁷ *Id.*

⁹⁸ U.S. Dep't of the Treasury, Interim Report to Cong. On Int'l Econ. and Exch. Rate Policy (July 1994), available at <http://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/Report%20to%20the%20Congress%20on%20International%20Economic%20and%20Exchange%20Rate%20Policies%20-%20July%201994.pdf>

⁹⁹ General Accountability Office, *Treasury Assessments Have Not Found Currency Manipulation, but Concerns about Exchange Rates Continue*, Report GAO-05-351, April 2005, available at <http://gao.gov/new.items/d05351.pdf>.

through the WTO.¹⁰⁰ In order for the United States to be successful in such an action, it would not matter that amended United States trade law would classify currency manipulation as an actionable subsidy. Currency manipulation would still need to be classified as a subsidy under the WTO treaty, something the WTO has not made any indication that it has intentions to do.¹⁰¹ Another glaring problem would be placing specific valuation on the extent of RMB misalignment. As explained in Part I, estimates range anywhere from 5.0% to 50.0%, and the bills as introduced would give the DOC great flexibility in determining what the exchange rate should be. This would in effect be telling China that “we [the United States] alone know the true value of the dollar-yuan exchange rate and have the authority to unilaterally penalize Chinese companies for pricing their products using the official exchange rate.”¹⁰² As explained above, there has never been a successful action brought through the DOC naming deliberate currency devaluation as either a direct or indirect subsidy by a foreign government.¹⁰³ This course of action, if followed through to actual imposition of duties, would apply additional duties on *all* exports from China, whereas countervailing duty law has historically been used to target industry or sector specific action. This has the potential to spark retaliatory measures by the China. Furthermore, there is danger that these actions are not WTO compliant, which raises additional concerns that members of Congress should consider.

Adjusting antidumping margins to account for exchange rate misalignment would also run into problems. Conceptually, antidumping penalizes individual companies who price their products at levels below fair-market value and sell in foreign markets, thereby hurting domestic

¹⁰⁰ James Bacchus, *What A Trade War With China Would Look Like*, FORBES, Feb. 2, 2009, available at http://www.forbes.com/2009/01/31/trade-wto-china-opinions-contributors_0202_james_bacchus.html

¹⁰¹ *Id.*

¹⁰² Dorn, *supra* note 4.

¹⁰³ See *Nucor Fastener*, *supra* note 76.

producers in those foreign markets.¹⁰⁴ Anticompetitive currency undervaluation, on the other hand, deals with macroeconomic policies that individual companies have no control over.¹⁰⁵ “If exchange rate undervaluation were to be taken into account in [antidumping] calculations, a product that is not dumped will suddenly have a dumping margin.”¹⁰⁶ This is parallel to the problems faced with imposing countervailing duties across the board on all Chinese companies, when the real focus should be on the macroeconomic policies being embraced at the highest levels of the Chinese government. While amending trade law does not seem like a viable option, there may be actions the Treasury could take through the Omnibus Trade and Competitiveness Act if it were amended to reflect more accurately upon the current economic climate.

Instead of reverting back to pre-2005 reform treatment of China’s exchange policies under the Omnibus Trade and Competitiveness Act of 1988, which requires a strict “yes or no” determination of whether a country is manipulating its currency for illegitimate reasons, I suggest potential amendments or clarifications to the Act which might create tiers or levels of currency intervention that could compel different actions by the Treasury. Instead of coming out and labeling China (or other countries) as a currency manipulator, having different categories that reflect the potential harm being done in the international community as a result of differing degrees of intervention could have differing degrees of compulsory action against the counterparty. Of course, this suggestion still falls under the umbrella of unilateral action by the United States and runs the risk of retaliatory or reactionary measures by those given a specific label, but it may inject more usefulness into the Omnibus Trade and Competitiveness Act of 1988 which has not compelled any serious remedial action in nearly 20 years.

¹⁰⁴ 19 U.S.C.A. § 1677(b) (2012) (West)

¹⁰⁵ Claus D. Zimmerman, *Congress Continues to Attack Currency Manipulation as China Defuses G-20 Pressure For Now: the International Law Issues*, THE AMERICAN SOCIETY OF INTERNATIONAL LAW, June 30, 2010, available at <http://www.asil.org/insights100630.cfm>

¹⁰⁶ *Id.*

A Balanced Multilateral Approach

Given the rapidly expanding rate of globalization, China's recent ascension to a global economic superpower, and the current state of the global economy,¹⁰⁷ it makes more logical sense to approach exchange rate misalignment on a multilateral basis. First this section will explore adversarial options that include appealing to organizations such as the WTO and IMF. Next it will discuss international economic forums, specifically the Group of Twenty, and I will make recommendations based on recent pledges by the Chinese government made to the international community.

International Economic Organizations

As made clear by the preceding sections, any unilateral action by the United States, though potentially helpful to members of Congress looking to get reelected, is likely to be ineffective, potentially hypocritical, and perhaps will violate commitments made by the United States to the WTO. Yet year after year these bills get introduced and bounced around through Congress, likely with the intention to show China that if they do not continue with substantial currency reform, we have weapons in our arsenal that are ready to counter these perceived unfair trade practices.

A more sensible, and likely more effective approach is a collaborative, multilateral engagement between the United States, China, and other leading global economies. This section will first explore the existing international organizations of the WTO and IMF and how they may handle allegations of currency manipulation. Next this section will take a look at the Group of Twenty, and examine the potential for multilateral engagement through this cooperative

¹⁰⁷ See Lin, *supra* note 6.

international forum. Finally, I will make recommendations that combine some of the beneficial aspects of each, which would help promote cooperation and mutually beneficial action.

Appealing to the World Trade Organization or the International Monetary Fund

Appealing to international economic organizations such as the WTO or IMF, at first glance, seems like a logical and potentially effective means of settling exchange rate management disputes. However, there exists somewhat of a paradox between these two organizations where exchange rate misalignment seems to fall through the cracks: while the WTO is charged with governing rules concerning international trade, and possesses relatively effective enforcement mechanisms¹⁰⁸, the IMF has jurisdiction over exchange rate issues but lacks any effective means of enforcement.¹⁰⁹

The WTO is the premier international organization for promoting fair trade practices among all of its members.¹¹⁰ Its primary focus is on traditional unfair trade practices such as government subsidies to domestic industries.¹¹¹ However, similar to the problems faced under United States trade law as evidenced by the legislation described above, it is unclear that intentional currency undervaluation would be considered an actionable subsidy under the existing WTO framework. China has repeatedly stated that its exchange rate policy is not designed to give it an unfair advantage in international trade, a threshold requirement under both United States and international law, but to promote economic stability.¹¹² Therefore, this

¹⁰⁸ “If a country believes another country has violated WTO rules, to its detriment, it may request the appointment of a dispute settlement panel to hear its complaint. [Once reviewed by the panel,] if the losing party does not comply with the ruling within a reasonable period of time, the WTO may, if requested by the complaining party, authorize it to impose retaliatory measures against the offending country or to take other appropriate retaliatory measures against that country’s trade.” JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS22658, CURRENCY MANIPULATION: THE IMF AND WTO (2011).

¹⁰⁹ *Id.*

¹¹⁰ *Agreement Establishing the World Trade Organization*, 1995, preamble.

¹¹¹ Sanford, *supra* note 108.

¹¹² Morrison, *supra* note 46.

exchange policy “cannot be said to frustrate the intent of GATT in contravention of Article XV given its role is raising living standards and employment.”¹¹³

China also generally seems to be in compliance with IMF obligations regarding exchange rate management. The IMF was established during the Bretton Woods meetings, and now has near universal membership with the exception of North Korea, the Vatican, and a handful of small European countries.¹¹⁴ Its main purposes are to maintain equilibrium in members’ balance of payments and to stabilize currency exchange rates.¹¹⁵ A careful and in-depth analysis done by Bryan Mercurio and Celine Sze Ning Leung in “*Is China a ‘Currency Manipulator’?: The Legitimacy of China’s Exchange Regime Under the Current International Legal Framework*” concludes that China is in compliance with the IMF articles agreement, specifically its technical determination of its exchange rate, mechanics used to maintain the rate within a targeted range, and capital controls used to monitor financial flows into and out of the country.¹¹⁶ Even if it could be proven that China was in violation of the IMF articles of agreement, the IMF lacks any serious mode of enforcement and would likely be hesitant to employ such drastic measures unless a very serious situation called for it.

Bringing an action against China with either the WTO or IMF with respect to currency manipulation is unlikely to be successful to any serious degree. The only likely outcome is that such action would most likely just lead to strained U.S.-China relations by what some consider simply boils down to a “name-and-shame” tactic against China.¹¹⁷

The Group of Twenty and International Economic Forums

¹¹³ Mercurio & Ning Leung, *supra* note 21, at 1300.

¹¹⁴ Sanford, *supra* note 108.

¹¹⁵ Robert M. Barnett, *Exchange Rate Arrangements in the International Monetary Fund: the Fund as a Lawgiver, Adviser, and Enforcer*, 7 Temp. Int’l & Comp. L.J. 77 (1993).

¹¹⁶ See Mercurio & Ning Leung, *supra* note 21, at 1299.

¹¹⁷ REBECCA M. NELSON, CONG. RESEARCH SERV., R40977, THE G-20 AND INTERNATIONAL ECONOMIC COOPERATION: BACKGROUND AND IMPLICATIONS FOR CONGRESS (2013).

The “Group of Twenty, or G-20, is a forum for advancing international economic cooperation and coordination among 20 major advanced and emerging-market economies.”¹¹⁸ The G-20’s predecessor, the G-7, was made up of Canada, France, Italy, Japan, the United Kingdom, and the United States, and was formed after World War II in an effort to coordinate international economic efforts.¹¹⁹ While the G-7 still convenes periodically, the G-20 has become the premier forum for advancing international economic cooperation and has added Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Korea, and the European Union.¹²⁰ The G-20 was officially formed in 1999 with its first meeting in Canada the following year.¹²¹ but held its first summit in 2008 in Washington, D.C., in a response to the global financial crisis.¹²² The G-20 members now represent two-thirds of the world’s population, 90% of global GDP, 80% of world trade, and produce 84% of the world’s fossil fuel emissions.¹²³ On its website, the G-20 claims its major accomplishments include “strengthening the role of emerging economies, such as BRICS, reforming international financial institutions, improving discipline and tightening oversight over national financial institutions and regulators, improving the quality of financial regulations in economies whose regulatory problems led to the crisis, and creating financial and organizational safety nets to prevent severe economic slumps in the future.”¹²⁴

In theory, an economic forum of this size and breadth should be an effective means to attaining international economic stability and cooperation. One instance where the G-20 has proven to be remarkably effective was during the financial crisis of 2008. When member

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ THE G20: ITS ROLE AND LEGACY, http://www.g20.org/docs/about/part_G20.html (last visited Apr. 9, 2013).

¹²² *Id.*

¹²³ Arvind Panagariya, *The G-20 Summit and Global Trade: Restore Credit and Resist Protectionism*, BROOKINGS, March 14, 2009, available at <http://www.brookings.edu/research/opinions/2009/03/14-g20-trade-panagariya>

¹²⁴ *supra* note 121.

countries were faced with very serious and dire financial problems, each had an incentive to sit down at the bargaining table and work out mutually beneficial solutions to problems being faced worldwide.¹²⁵ Critics however claim, that similar to the IMF, any agreements or pronouncements made during these G-20 meetings and summits lack any meaningful enforcement mechanism beyond “naming and shaming.”¹²⁶

Recommendation

A nation’s exchange rate policy is one facet of a highly complex global economic landscape, and a system of threats, sanctions, and name-calling is not a sustainable or effective strategy to promote general international prosperity. Recent economic indicators continue to show that the RMB has been consistently appreciating against the dollar, and other econometrics imply that imbalances between China and the United States are gradually moving toward equilibrium. Since major currency reforms began in 2005, the RMB has appreciated 33.8% based on the real effective exchange rate, which accounts for other monetary pressures such as inflation and a country’s purchasing power.¹²⁷ China’s economy has been growing at dizzying rates over the past decade, but recently it has started to cool off. In 2011 its real GDP growth slowed to 9.1%, and further in 2012 to 7.8%.¹²⁸ Consensus forecasts see China’s GDP growth stabilizing around 8.0% over the next two years.¹²⁹ Despite this strong growth, the global economic environment weakened in the latter half of 2012, partly due to decreased export output from Japan and the Euro Zone.¹³⁰

In March 2013 at the National People’s Congress, China’s new leadership pledged to “steadily carry out reforms to make interest rates and the RMB exchange rate more market-

¹²⁵ NELSON, *supra* note 117.

¹²⁶ NELSON, *supra* note 117.

¹²⁷ Report to Cong. On Int’l Econ. and Exch. Rate Policies, *supra* note 43.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

based.”¹³¹ These pledges were a reiteration of the February 2013 G-20 Finance Ministers and Central Bank Governors Meeting in Moscow, where China pledged not to “target exchange rates for competitive purposes, and reaffirmed their commitment to move more rapidly toward more market-determined exchange rate systems and exchange rate flexibility to reflect underlying fundamentals.”¹³² They also pledged only to actively intervene in foreign exchange markets when necessary to quell excessive volatility.¹³³

These promises made by Chinese leadership seem to be in line with what the rest of the global economic community, specifically the United States, has been looking for from China for years. A number of steps should be taken by China in the coming years to help its exchange rate reach a market-determined rate as they have committed to at the G-20.

A first step China could take is to continue to further liberalize its capital controls.

Recently, the global community has seen limited progress in this area:

“In line with its commitments in the SE&D, China more than doubled the total dollar amount that foreigners can invest in China’s stock and bond markets under its Qualified Investor Institutional Investor program from \$30 billion to \$80 billion. China has also permitted some offshore banks and financial institutions to invest RMB holdings into the domestic interbank bond market; allowed for the development of cross-border exchange traded funds between Hong Kong and mainland China; made it easier for domestic Chinese firms to raise funds in the offshore market by issuing offshore RMB-denominated bonds; [among other things].”¹³⁴

China should continue with these financial reforms, and the United States should encourage this reform with investment and support from its long-established financial institutions.

Another step China should take is to increase its foreign exchange transparency by subscribing to the IMF’s Special Data Dissemination Standard¹³⁵ on reserve transparency and

¹³¹ Report to Cong. On Int’l Econ. and Exch. Rate Policies, *supra* note 43.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *World Economic Outlook: Hopes, Risks, Realities*, *supra* note 30.

report to the IMF's Composition of Official Exchange Reserves Database.¹³⁶ This cooperation with international standards would give legitimacy to the promises being made by China's new leadership and prove to the global economic community that their exchange rate policies are not being carried out for illegitimate reasons.

If China continues with gradual appreciation of the RMB, loosens capital controls, and follows through with promises made during G-20 meetings and other international economic summits, no action by the United States or any other organization is necessary. As explained in Part I, an immediate and drastic appreciation of the RMB could have a doomsday effect on the Chinese economy, specifically the underdeveloped banking system and manufacturing sector. The United States should adopt a wait-and-see approach, and give the new Chinese administration the opportunity to carry out its promises. But what if China does not? What if capital controls tighten, rapid foreign reserve accumulation and market intervention persists (or grows as in the first quarter of 2013), and the RMB is significantly undervalued? The only viable option would be inter-organization cooperation.

While the WTO does not seem to have jurisdiction over exchange rate issues, and the IMF and G-20 do not have any enforcement mechanisms, a combination of the strengths of each could act as an enforcer for deliberate and detrimental exchange rate misalignments. Currently there is an interagency agreement between the WTO and IMF, and this could be amended to overcome the obstacles facing both organizations' treatment of exchange rate issues.¹³⁷ I believe adding the G-20 to this agreement could give proclamations and promises made much more force. A framework as follows could be effective in promoting and enforcing global exchange

¹³⁶ *Id.*, "Data dissemination standards are important because they help enhance the availability of timely and comprehensive statistics, which contributes to the pursuit of sound macroeconomic policies and efficient functioning of financial markets."

¹³⁷ SANFORD, *supra* note 108.

rate policies. First, leaders from the G-20 meet annually to set goals regarding exchange rate policies and reforms which include specific targets for each member nation. Once an agreement is reached, the agreement could be submitted to the IMF for monitoring. During periodic reviews, if the IMF determines a country is in violation of its agreement, it could refer the matter to the WTO for enforcement or compulsory dispute resolution. If the country refuses to comply with any part of this process, then the IMF in conjunction with the World Bank would have the power to engage in countervailing currency intervention.¹³⁸ Countervailing currency intervention initiated from a global economic organization would be more beneficial and likely more effective than unilateral action as proposed by some in the United States.

Conclusion

Trying to isolate foreign exchange policy as an independent economic issue is not an effective macroeconomic management strategy. Blaming an undervalued RMB for America's economic woes is politically attractive for United States politicians because it creates a boogeyman that distracts the American people from many of the internal problems created by these same politicians. Instead of the United States grabbing a torch and pitchfork and trying to force the world's second largest economy to undergo a radical and immediate rebalancing of its economy, we should continue negotiations and talks to help promote a gradual and fair rebalancing of the global economy as a whole. Empowering existing international economic organizations to take action when there is indeed an abuse of the system is the only way for such action to gain legitimacy, and would keep the focus on those committing the wrongs and not

¹³⁸ As described in Part II, but initiated and carried out by the World Bank and IMF rather than unilaterally by the United States.

those who are the accusers. “Multilateralism – with a more prominent role for emerging market countries – is essential now to prevent competitive currency debauchery by China and the US from blowing up the system.”¹³⁹

¹³⁹ Arvind Subramanian, *America cannot win the currency wars alone*, FINANCIAL TIMES, OCT. 20, 2010, available at <http://www.ft.com/intl/cms/s/0/7fb95280-dc8b-11df-a0b9-00144feabdc0.html#axzz2S9dBW8dy>.