



# FAIR CURRENCY COALITION

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## BEFORE THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

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### WRITTEN STATEMENT OF THE FAIR CURRENCY COALITION

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#### FOR THE HEARING ON CHINA'S EXCHANGE RATE POLICY (March 24, 2010)

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The Fair Currency Coalition (“FCC”) consists of manufacturing, agricultural and labor groups seeking an effective, lasting solution to the growing problem of currency misalignment. A list of the FCC’s members is attached.

The FCC appreciates this occasion to be heard on the critical subject of China’s exchange rate policy. China is not the only country to pursue a mercantilist currency policy, of course, but it is the most prominent one and the one that is sometimes hailed as a model for developing countries. As our views on the nature of the problem and its impact on American industries and workers are well known,<sup>1</sup> this statement focuses primarily on the issue of whether and how a solution might be found in the “multilateral approach” to the problem of currency manipulation that is often invoked as an alternative to the use of national trade remedies.

#### **The United States Has Pursued A Multilateral Solution for Years to No Avail**

Continuing calls for a “multilateral solution” obscure the plain fact that the United States has tried for years to use every multilateral means to persuade China, in particular, to adopt a more market-based currency regime. The past two administrations have repeatedly raised the issue in meetings of the G-7, the G-8, the G-20, the World Bank, and the International Monetary Fund --- all to no avail.

The G-20 considers itself “the premier forum for our international economic cooperation.”<sup>2</sup> On September 24-25, 2009 in Pittsburgh, the G-20 agreed, among other things, “to launch a framework that lays out the policies and the way we act together to generate strong, sustainable

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<sup>1</sup> For more information, consult our website: <http://www.faircurrency.org>.

<sup>2</sup> Leaders’ Statement: The G-20 Summit in Pittsburgh, September 24-25, 2009, at para. 19.

and balanced global growth” and “to reform the global architecture to meet the needs of the 21<sup>st</sup> century.” As Treasury Secretary Tim Geithner has made clear, a change in the value of the renminbi is one critically important step to achieve “strong, sustainable and balanced growth.”<sup>3</sup> So, at least from the perspective of the United States, the G-20 formula implicitly recognizes the need for a currency realignment.

On March 29, President Obama and four other leaders wrote a letter to the rest of the G-20 regarding the agenda for the next G-20 summit to be held in Toronto on June 26-27, 2010. Nine months after the Pittsburgh meeting, the five leaders wrote:

We all understand that ongoing trade, fiscal and structural imbalances cannot lead to strong and sustainable growth. Without cooperative action to make the necessary adjustments to achieve that outcome, the risk of future crises and low growth will remain. All G20 countries must move quickly to implement the first steps of the new Framework agreed to in Pittsburgh – to report robustly on what each of us can do to contribute to strong, sustainable and balanced growth.

Even at a time of financial and economic crisis, the multilateral process moves slowly. Seven months after the Pittsburgh meeting, the G-20 leaders must exhort the group to “*move quickly to implement the first steps*” of the new Framework. Note, too, that divisive issues are not referred to directly. There is no mention of currency issues in the Pittsburgh statement or in the March 29 letter. Of necessity, multilateral diplomacy consists of endless talk and the extensive use of coded words and phrases. Differences tend to be papered over, not resolved.

Multilateral diplomacy has been tried repeatedly by the current and the previous U.S. administrations and has consistently failed to produce any concrete result in terms of more realistic, market-based exchange rates. We do not argue that multilateral diplomacy should be abandoned. Instead, we are convinced that a new approach is needed. As Martin Wolf wrote in the Financial Times, “The US was right to give talking a chance. But talk must lead to action.”<sup>4</sup>

The rest of this statement assesses the limitations arising from existing multilateral rules and institutions in dealing with currency misalignment and proposes a new strategy based on the use of national trade laws consistent with our rights and obligations under multilateral agreements.

### **Relevant IMF Rules Are Too Weak to be Effective**

At the conclusion of World War II, a new international monetary system was created and the International Monetary Fund was established to oversee it. A principal responsibility of the IMF is surveillance of member countries’ exchange rates.

The rules governing undervalued currencies are contained in Section 1 of Article IV of the IMF’s Articles of Agreement:

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<sup>3</sup> See, for example, his speech at Peking University, June 1, 2009.

<sup>4</sup> “Evaluating the renminbi manipulation,” Financial Times, April 7, 2010.

## **Section 1. General obligations of members**

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

- (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
- (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
- (iii) 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; and
- (iv) follow exchange policies compatible with the undertakings under this Section.

Subsection (iii) is the heart of the matter: all 186 IMF member countries are obligated 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 over other members.” The language used is “*shall avoid* . . . .,” making clear that there is a legal obligation not to manipulate one’s exchange rates. It is also clear that the objective is not rigid, unchanging exchange rates, as Chinese representatives sometimes imply. Rather, the overarching objectives are economic and financial stability and sustained, sound economic growth on a global basis, aims that are echoed in the recent G-20 statements. The obligation of IMF members is to allow exchange rates to respond to market forces as necessary to correct imbalances in payments and avoid the creation of an unfair competitive advantage.

Despite the apparent clarity of the IMF obligations, China has effectively held down the value of its currency, the renminbi (“RMB”) or yuan, against the U.S. dollar for 16 years. For all but three years (July 2005 – July 2008), the RMB has been tightly pegged to the dollar. The results of China’s policy are startling. In just the past eight years, China has amassed a cumulative trade surplus in manufactured good of \$1.6 trillion dollars, while its official reserves have skyrocketed to \$2.4 trillion.

Over the past decade, the IMF has proved impotent to address the problem despite its mandate to exercise “firm surveillance over the exchange rate policies of members.”<sup>5</sup> The IMF holds annual bilateral consultations with China and every other member of the IMF on exchange issues under Article IV. The Fund has recommended repeatedly that China adopt a “more flexible” exchange rate regime. Its advice has gone unheeded.

Consistent with its mandate to “adopt specific principles for the guidance of all members with respect to those [exchange rate] policies,” the Fund has also issued several policy guidelines since 1997. The latest additional guideline, approved in June 2007, refines the concept of “currency manipulation” by adding the principle that IMF members should avoid “exchange rate policies that result in external instability.” In other words, each IMF member is instructed to consider the effects its currency policies have on trading partners and the system as a whole.

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<sup>5</sup> IMF Article IV, Section 3(b).

China's response has been to ignore the IMF's guidelines as well as its recommendations. For the past three years – that is, every year since 2006 -- China has gone farther, successfully blocking the release of the 2007, 2008, and 2009 reports on completed annual Article IV consultations. China's 3.65 percent voting share is not large enough to veto any formal decision of the IMF.<sup>6</sup> Instead, China is able to block reports it doesn't like, apparently merely by saying "no" to their public release.

The lesson that can be drawn from this history of futility is: even when backed by the IMF's legal obligations and policy guidelines, moral suasion has proved inadequate to convince a large, unwilling member to reform its currency policy. Attempts at moral suasion by groups that lack *any* legal powers – the G-8 and the G-20, for example – are even less likely to convince such a country.

### **Existing WTO Rules Are Too Weak and Untested to Be Effective**

The General Agreement on Tariffs and Trade, the basic trade contract on which the post-war trading system is based, gives some attention to currency issues. One such provision lies in Article XV, Section 4:

Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.

Some observers see in this broad language the possibility of action by the WTO, the successor to the GATT. It should be possible, for example, to build a legal case on the argument that currency misalignment constitutes an export subsidy, a practice prohibited on manufactured goods by GATT Article VI. In addition, it might be possible to argue that misalignment constitutes a *de facto* additional levy on imports, nullifying and impairing the tariff bindings under GATT Article II that have been the chief bulwark against a resurgence of 1930's-style protectionism.

While there is little question that an undervalued currency has those deleterious effects on key elements of the basic trade contract among WTO members, it is far less clear what action the WTO might take in response to a complaint brought by the United States or a group of countries.

Novel issues pose substantial problems for the WTO's ad hoc dispute settlement panels and the standing Appellate Body. Panelists are drawn from the trade policy establishment around the world. Their knowledge and experience vary, of course, but few of them have any grounding in monetary affairs. As a consequence, it is difficult to know in advance how they would analyze, much less resolve, disputes centering on IMF standards and concepts.

Moreover, the WTO arguably lacks a clear mandate to deal with these issues on its own. Instead, GATT Article XV, paragraph 2 requires the WTO to "consult fully with the International

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<sup>6</sup> Only the United States, with 16.74 percent, has sufficient voting power to block a decision.

Monetary Fund” in cases dealing with “monetary reserves, balances of payments or foreign exchange arrangements.” Worse yet, the WTO is obligated by that same paragraph of Art. XV to “accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund.”

In other words, the same IMF that cannot find a way to issue its own consultation reports or to enforce its own policy guidelines is supposed to supply the definitive determination on which WTO action would hinge. This institutional arrangement seems unworkable, calling into question any hope for timely, effective action under Article XV.

### **An Intelligent Approach to a Multilateral Solution**

In the final analysis, only multilateral action can be expected to remedy the deficiencies in multilateral rules and institutions. One direct approach, advocated by Arvind Subramanian of the Peterson Institute for International Economics and Aaditya Mattoo of the World Bank, would be to amend the WTO rules expressly to prohibit currency undervaluation. They choose the WTO over the IMF because undervaluation has clear trade effects and because the IMF has no enforcement powers, especially when it comes to large creditor nations – just the ones who might benefit from an undervalued currency. Theoretically, it would be possible to amend the GATT or to add this issue to the long-stalled Doha Round negotiations. Either process looks to be endless.

The issue before the Obama administration, the Congress and the world is how best to achieve a fair, effective and durable solution under the international rules – a solution that resolves not just the immediate case of China but also establishes effective legal norms to prevent future cases from growing so large. The most sensible, pragmatic and legally defensible strategy would be:

- as a matter of policy, to direct the Department of Commerce to begin enforcing the U.S. antidumping and countervailing duty remedies to offset currency subsidies in a manner consistent with our WTO obligations;
- as a matter of prudence, to enact the Currency Reform for Fair Trade Act (H.R. 2378) to establish as clearly as possible for U.S. courts the intent of the Congress that the law be applied to remedy currency subsidies;
- to prepare for a WTO challenge against our use of the anti-subsidy remedies available under national law; and
- to open broader multilateral discussions on how best to address the deficiencies in the current international system of rules and disciplines.

By acting decisively on our legitimate interests and doing so within the existing framework of international rights and obligations we would have the best chance of driving a multilateral process to a useful conclusion. By acting first, we help to ensure that we can defend our actions rather than carry the heavy burden of proof that someone else’s practices, which often lack transparency, violate provisions that have rarely if ever been enforced by the IMF or the WTO, even in the face of egregious violations. Our example of using existing countervailing duty remedies would encourage other trading partners to act in a similar way. Only by acting first,

can the United States lead in securing a lasting multilateral solution to the problem of currency misalignment.

Attachment

**FAIR CURRENCY COALITION: MEMBERS**  
**(As of February 19, 2010)**

1. Allegheny Technologies Incorporated
2. American Corn Growers Association (ACGA)
3. American Cotton Shippers Association
4. American Federation of Labor Industrial Union Council
5. American Foundry Society
6. American Iron and Steel Institute
7. American Manufacturing Trade Action Coalition
8. American Mold Builders Association
9. Bakery, Confectionary, Tobacco Workers and Grain Millers International Union (BCTGM)
10. Coalition for a Prosperous America
11. Communication Workers of America (CWA)
12. F & L Metal Finishes, Inc.
13. The Copper & Brass Fabricators Council, Inc.
14. International Association of Machinists and Aerospace Workers (IAM)
15. International Brotherhood of Boilermakers (IBB)
16. International Brotherhood of Electrical Workers (IBEW)
17. International Federation of Professional Employees (IFPTE)
18. Lapham-Hickey Steel Corporation
19. Manufacturers Association of Central New York (MACNY)
20. Metals Service Center Institute
21. National Council of Textile Organizations
22. National Textile Association
23. National Tooling and Machining Association
24. North American Die Casting Association
25. Nucor Corporation
26. Organization for Competitive Markets
27. Penn United Technologies, Inc.
28. Precision Machined Products Association
29. Precision Metalforming Association
30. Sheet Metal Workers International Association (SMWIA)
31. Specialty Steel Industry of North America
32. Spring Manufacturers Institute
33. Steel Dynamics, Inc.
34. Steel Manufacturers Association
35. Tooling & Manufacturing Association
36. Tooling, Manufacturing, and Technologies Association
37. United Automobile Workers (UAW)
38. Universal Electric Corporation
39. United Mineworkers of America (UMWA)
40. United States Business & Industry Council
41. United Steelworkers of America (USW)
42. US Industrial Fabrics Institute
43. Wisconsin Paper Council
44. Wood Machinery Manufacturers of America (WMMA)
45. Vanadium Producers & Reclaimers Association
46. Xcel Mold and Machine, Inc.