

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

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**WRITTEN STATEMENT OF  
THE COMMITTEE TO SUPPORT U.S. TRADE LAWS**

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**FOLLOWING THE HEARING ON MARCH 24, 2010,  
REGARDING CHINA'S EXCHANGE RATE POLICY  
(April 7, 2010)**

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The Committee to Support U.S. Trade Laws (“CSUSTL”) is an organization of companies, trade associations, labor unions, workers, and individuals committed to preserving and enhancing U.S. trade laws. CSUSTL’s members span all sectors, including manufacturing, technology, agriculture, mining and energy, and services. CSUSTL is dedicated to ensuring that the unfair trade laws are enforced and not weakened through legislation or policy decisions in Washington, in international negotiations, or through dispute settlements at the World Trade Organization (“WTO”) and elsewhere. CSUSTL appreciates the opportunity to submit this written statement on China’s exchange-rate policy.

**I. National and International Regulation of Exchange Rates**

Control over a country’s currency in the first instance is the responsibility of that country’s government and a function of national sovereignty. At the same time, since the competitive currency depreciation that played a large role in contributing to the Great Depression globally in the 1930s, there has been a general recognition that countries’ exchange-rate policies can have undesirable international consequences. As a result, certain rights and obligations have arisen in public international law – primarily in agreements overseen by the International Monetary Fund (“IMF”) and the World Trade Organization (“WTO”) – that are meant to prevent, or at least to curtail, disruptive imbalances in international trade and investment attributable to inappropriate exchange-rate arrangements. These agreements constitute a significant ceding of national sovereignty by the member states of the IMF and the WTO over currency matters.

Thus, Article IV of the IMF’s Articles of Agreement states that each member of the IMF 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. In 2007, the IMF updated its guidance to members under Article IV by adding a principle recommending countries avoid exchange-rate policies – undertaken for whatever reason – that cause external instability.

Similarly, Article VI of the WTO’s General Agreement on Tariffs and Trade (“the GATT”), as augmented by the WTO’s Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) and the WTO’s Antidumping Agreement, recognizes that multiple currency

practices by governments can in certain circumstances constitute a subsidy to exports or a form of dumping through partial depreciation and can be offset by countervailing or antidumping duties. Article XV of the GATT also provides that member states of the WTO shall not, by exchange action, frustrate the intent of the GATT's Articles and shall not, by trade action, frustrate the intent of the IMF's Articles of Agreement. Article XV further sets forth guidelines on how the IMF and the WTO are to work in tandem on issues generated by the intersection of international trade and exchange rates.

This dual jurisdiction of the IMF and the WTO reflects the hybrid nature of exchange rates as a monetary measure with far-reaching repercussions for international trade and investment. Also of importance is that the governmental intent that is a criterion for a finding of currency manipulation under Article IV of the IMF's Articles of Agreement is not a prerequisite for imposing countervailing or antidumping duties under the WTO's provisions, which only focus upon the subsidization or dumping, the subsidy's export-contingency, and injurious effects caused by the unfair pricing.

## **II. Addressing on a Multilateral Basis the Fundamental Misalignment of China's Renminbi and Other Countries' Currencies**

### **A. China's Fundamentally Undervalued Renminbi Is a Highly Protectionist and Destabilizing Measure Contrary to China's International Legal Obligations**

China, as a member state of both the IMF and the WTO, is bound by public international law to abide by those institutions' requirements. In connection with its accession to the World Trade Organization in December 2001, China noted that it had had since 1994 a single and managed floating exchange-rate regime based upon supply and demand and underscored that it would abide by its obligations with respect to foreign-exchange matters in accordance with the provisions of the WTO Agreement and related declarations and decisions of the WTO that concern the IMF.<sup>1</sup>

China, however, does not have a floating exchange-rate regime and has fallen far short of honoring these commitments. For nearly sixteen years, China has engaged in enforced undervaluation of its currency, the renminbi. This fundamental misalignment has been achieved by means of the Chinese government's pegging of the renminbi to the U.S. dollar and extensive currency controls and massive and protracted intervention in exchange markets. There is broad consensus that the renminbi is undervalued, and the Peterson Institute estimates that the renminbi is misaligned by about 40 percent relative to the U.S. dollar. China's intervention in the exchange markets is now approximately \$30 - \$40 billion per month.

China's fundamental misalignment of its currency is a classic protectionist measure. The renminbi's undervaluation acts as a deterrent to imports into China and facilitates exports from China, while fostering jobs and foreign direct investment in China at the expense of the United States and other countries. The Economic Policy Institute recently has issued a report that the

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<sup>1</sup> See "Report of the Working Party on the Accession of China," WT/ACC/CHN/49, at paras. 31 and 35 (Oct. 1, 2001).

renminbi's substantial undervaluation has been a major reason for the United States' imbalanced trade with China, the loss of 2.4 million manufacturing jobs in the United States between 2001 and 2008, and depressed and lower wages for many more millions of U.S. workers.<sup>2</sup> From 2002 to 2009, the United States ran a cumulative trade deficit of nearly \$5.4 trillion for All Merchandise, including a deficit of almost \$1.6 trillion with China. China's share of the U.S. trade deficit in All Merchandise rose from 22 percent in 2002 to 45.3 percent in 2009.<sup>3</sup>

Perhaps the clearest yardstick of how damaging and extensive the renminbi's undervaluation has been can be seen in the enormous foreign reserves that China has been gaining at a rapid rate. This growing accumulation of foreign reserves persisted even during the time when China loosened the renminbi's peg to the U.S. dollar for a while. In July 2005, China allowed a revaluation of the renminbi, from 8.28 renminbi/\$1 to 8.11 renminbi/\$1. From then until July 2008 when China reinstated the peg, China permitted the renminbi to strengthen further to 6.82 renminbi/\$1, a nominal appreciation in total of approximately 17.5 percent. Nevertheless, during these three years China's foreign reserves (exclusive of the foreign reserves held by Hong Kong and Macao) rose from \$711 billion to \$1.8 trillion. By the end of 2009, China's foreign reserves (again apart from the foreign reserves of Hong Kong and Macao) were typically cited as having risen further to about \$2.4 trillion, but could well be closer to \$3 trillion, even as China has continued to invest in a wide range of assets around the world.<sup>4</sup>

In summary, the renminbi's fundamental misalignment undercuts and prevents a sustainable flow of trade across national boundaries. As Harry Dexter White, the chief negotiator of the United States at Bretton Woods, observed at the time of the IMF's founding in 1944, "A depreciation in exchange rates is an alternative method of increasing tariff rates; and exchange restriction is an alternative method of applying import quotas."<sup>5</sup> By the same token, as Chairman Bernanke noted in a speech in Beijing on December 15, 2006, "Greater scope for market forces to determine the value of the RMB would also reduce an important distortion in the Chinese economy, namely, the effective subsidy that an undervalued currency provides for Chinese firms that focus on exporting rather than producing for the domestic market." In a forum sponsored by the Economic Policy Institute on March 12, 2010, Nobel Laureate Paul Krugman echoed Chairman Bernanke by calling the renminbi's fundamental misalignment a measure that should be treated as a countervailable subsidy.

## **B. Multilateral and Bilateral Efforts to Date Have Not Resolved the Issue**

China's exchange rate with the United States today continues to be 6.82 renminbi/\$1, and the adverse effects of the renminbi's and other foreign currencies' undervaluation relative to the

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<sup>2</sup> Robert E. Scott, "Unfair China Trade Costs Local Jobs" (Economic Policy Institute, Mar. 23, 2010).

<sup>3</sup> See Fair Currency Coalition, "Fact of the Week – RMB Peg Fuels China Trade Surpluses, Undercuts U.S. Recovery" (Feb. 23, 2010), [available at, www.faircurrency.org](http://www.faircurrency.org).

<sup>4</sup> See Fair Currency Coalition, "Fact of the Week – China's Record Reserves" (Jan. 26, 2010), [available at, www.faircurrency.org](http://www.faircurrency.org).

<sup>5</sup> H.D. White, "The Monetary Fund: Some Criticisms Examined," 23 *Foreign Affairs* 195, 208 (1944-45).

U.S. dollar threaten the recovery of the U.S. and global economies. Despite this predicament, and despite the broad consensus that the undervaluation of the renminbi and other currencies is considerable, the IMF has been able only to draw attention to this situation, because the agency is not empowered to do more and certainly cannot compel revaluation. The IMF's position is so circumscribed under its Articles of Agreement that China has been able to block publication of the IMF's 2007, 2008, and 2009 annual surveillance reports under Article IV.<sup>6</sup>

Similarly, there appears to have been little or no coordination between the IMF and the WTO on this situation even though, as mentioned earlier, Article XV of the General Agreement on Tariffs and Trade speaks to the respective roles of these two international organizations in matters pertaining to issues that have monetary and trade aspects. In addition, while the WTO has its various agreements, including its Understanding on the Settlement of Disputes, the WTO has not acted on this problem, and no member state has opted for dispute settlement thus far.

Lastly in this regard, discussions on this subject by the G-20 finance ministers, in the U.S.-China Strategic and Economic Dialogue, and during other bilateral meetings between senior officials of China and the United States at the highest levels have not persuaded China thus far to modify its mercantilist behavior.

### **C. The Imperative for Meaningful Multilateral Action Without Delay**

It is evident from the foregoing that China's unwillingness to revalue the renminbi is deep-seated. China's political leaders regularly cite "stability" as justification for fixing the renminbi's value within a narrow range. While that term can be variously interpreted, Chinese authorities in the past have stressed (a) the need for China's economy to generate 20-25 million new jobs each year<sup>7</sup> and (b) low profit margins on many Chinese exported goods of less than 2 percent<sup>8</sup> as reasons to avoid large changes in the renminbi's value. China's undervaluation of the renminbi also has been spurring (a) the huge foreign reserves noted earlier that have enabled China to purchase assets around the world to ensure a steady supply of raw materials and strengthen China's economy and national security, (b) large trade surpluses, and (c) foreign direct investment in China. From China's narrow perspective, these factors apparently are seen as conducive to "stability."

The problem, however, is that China's policy is one of protectionism at the expense of other nations and actually is creating instability by way of increasingly dangerous economic and monetary imbalances on an unprecedented scale. These imbalances are undesirable for the United States, for China's other trading partners, and ultimately for China as well. Neither the United States nor any other country can run extensive and debilitating trade deficits on an open-

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<sup>6</sup> See Fair Currency Coalition, "Fact of the Week – The International Monetary Fund (IMF) Record on Currency Manipulation" (Feb. 2, 2010), [available at, www.faircurrency.org](http://www.faircurrency.org).

<sup>7</sup> International Monetary Fund, Country Report No. 04/351, "People's Republic of China: 2004 Article IV Consultation – Staff Report" at 12-13 (Nov. 2004).

<sup>8</sup> The Wall Street Journal, Asia News, "China Official Warns of Currency Risks" (Mar. 18, 2010) (statement by Vice Commerce Minister Zhong Shan that further appreciation of the renminbi risks driving Chinese exporters out of business).

ended basis. In the end, China's best chance of stimulating jobs and achieving "stability" without excess production and inflation in China will be through balanced and sustainable growth. Increased flexibility in the renminbi's exchange rate will be critically important in the realization of this goal and orderly resolution of global imbalances. A greater reliance by China on exchange rates that reflect market fundamentals is also vital for the United States to bolster its manufacturing base and economy.<sup>9</sup>

#### **D. A Proposal**

At this stage, after so many years without a constructive resolution of this worsening situation, the international community should feel a compelling urgency to address competitive currency depreciation effectively before conditions deteriorate further. Even now, unfortunately, it is questionable whether China is prepared unilaterally to shift from its contradictory policy of "stability" via rigid exchange rates and to revalue the renminbi sufficiently and quickly enough. Morgan Stanley has said that it expects China will permit the renminbi to appreciate to 6.54 renminbi/\$1 by the end of 2010 and to 6.17 renminbi/\$1 by the end of 2011.<sup>10</sup> Yet that nominal appreciation from the current rate of 6.82 renminbi/\$1 would be only 9.5 percent, about the same pace over the next 21 months that China set between July 2005 and July 2008. If that previous experience is any guide, that movement would probably be inadequate and would not stem the current imbalances in such areas as foreign reserves and trade from becoming more extreme. From the standpoint of the United States, further losses of jobs and increases in debt could be expected. Nor is it likely that the IMF under its current rules would have any real success in encouraging China to revalue the renminbi. The initial and fragile recovery from the global recession could very easily be undermined.

Stronger multilateral provisions are required to hold in check and to offset competitive currency depreciation by countries. The Bretton Woods system and the GATT took essential, first steps in the mid- and late 1940s (a) by formally recognizing that fundamentally misaligned exchange rates undo efforts to liberalize international trade and (b) by putting in place a framework under public international law by which members of the IMF and the GATT (now WTO) relinquished some sovereignty over exchange rates. It would have been ideal had this progress been solidified in the 1970s when the Bretton Woods' par-value mechanism was replaced with the present rules of the IMF, but that did not happen, and so the task of improving the international mechanism for the enforcement of orderly exchange rates remains.

As the present circumstances described above set forth, it is the negative and disruptive impact on balanced trade and investment across national boundaries that suffers when a country acts in a protectionist manner by seriously misaligning its currency's exchange rates over a

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<sup>9</sup> International Monetary Fund, Country Report No. 04/351, "People's Republic of China: 2004 Article IV Consultation – Staff Report" at 12-13 (Nov. 2004); and Secretary of the Treasury Timothy Geithner, "The United States and China, Cooperating for Recovery and Growth," Speech at Peking University – Beijing, China (June 1, 2009).

<sup>10</sup> Morgan Stanley, "China Economics – Renminbi Exit from USD Peg: Whether, Why, When, How," at 1 (Apr. 5, 2010).

prolonged period of time. It consequently makes sense to rely upon anti-protectionist, multilateral trade remedies as part of the solution to remedy that damage.

As a way of punctuating, therefore, that fundamental misalignment of a currency is not acceptable under public international law, CSUSTL supports H.R. 2378, The Currency Reform for Fair Trade Act, bipartisan legislation that would treat fundamental misalignment of a foreign currency as a prohibited countervailable export subsidy and authorize the imposition of either countervailing or antidumping duties on injurious imports into the United States from any country that fundamentally undervalues its currency.

This action is appropriate and necessary. First, this bill is a reasonable implementation in U.S. domestic law of the WTO's SCM Agreement and Antidumping Agreement. If China or any other country wanted to do so, it could contest the WTO-consistency of this legislation in dispute settlement at the WTO. Whether successful or not, such a challenge would draw attention to the critical need for enforceable, effective recourse in place under public international law to counter injury caused by fundamentally undervalued currencies.

Second, this bill is very much needed in the short term. Its passage would extend to materially injured U.S. companies and workers an immediate means to neutralize the unfair price advantage of imports that benefit from any other country's enforced currency depreciation. Over the longer term, the availability of this relief could serve as a deterrent to the practice of currency depreciation. This remedy would not be unilateral and protectionist, but instead would be multilateral and anti-protectionist under the current provisions of the WTO and the IMF.