

VIRTUES, THE CHINESE YUAN, AND THE AMERICAN TRADE EMPIRE

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The relative foreign exchange valuation of the yuan, or renminbi, against the dollar is one of the longest-running and highest profile battles between the United States and China. What does the dispute, and America's reactions to it, say about America's trade empire? Specifically, what do the reactions say about the character and values America historically holds dear, and proclaims to the world through its trade empire?

America's reactions emanate from the government, particularly Congress, and are largely unilateral and invariably loud. One reaction is to demand a quick, dramatic revaluation (if not free flotation) of the yuan. A second reaction is to threaten punitive tariffs on the order of 27.5 per cent against merchandise

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All errors are mine alone. The views expressed herein do not necessarily reflect those of any of the aforementioned persons or institutions.

originating in China. A third reaction is to change rules about designating a country a currency manipulator. A fourth reaction is to expand America's ability to impose antidumping duties, by requiring an adjustment in the dumping margin calculation to Export Price (or Constructed Export Price) for currency undervaluation. A fifth reaction is to ease rules on imposing countervailing duties against goods from non-market economies like China by deeming a misaligned currency a countervailable subsidy. Oddly, perhaps, a sixth potential reaction – America waives on testing existing trade rules, such as in GATT Article XV:4 on exchange rate action, that would frustrate the purpose of multilateral trade rules.

Do these responses – none of which has yet been implemented formally in American trade law or policy – to yuan-dollar misalignment befit a great trade empire? Or, if greatness and virtue are at all connected, then do they evince a lack of virtue? Do American's responses reveal its lack of practice of the Four Cardinal Virtues of prudence, moderation, courage, and justice?

The thesis here is that the China currency dispute arguably reveals the lack of virtue in the manner in which America presides over its trade empire. Far from displaying the Four Cardinal Virtues in its proposed legislative and policy responses to the challenge of yuan undervaluation, does the United States display their opposites or near-opposites: imprudence, gluttony, irresolution, and ineptitude?

On balance, the responses of the American trade empire to the challenge of the Chinese yuan seem to merit barely passing marks in respect of prudence and courage, and failing grades on moderation and justice. This evaluation is advanced as a proposition, not intended as a judgmental imposition. The key point about the assignment of marks is to provoke questions for thought and debate, not impose dark or definitive conclusions.

1. The Empire Thesis

“The three things that we care about most in China now are money, money, and money,’ an old friend of mine remarked mournfully. ... ‘It’s all money-grubbing,’ another friend said. ‘Many Chinese have lost their sense of morality or ethics.’”

Richard Bernstein¹

¹ “A Double Take on Mao in Money-Fixated China”, *International Herald Tribune* (Hong Kong edn), 16 July 2007, at 2.

Prudence, moderation, courage, and justice. They are the Four Cardinal Virtues in Roman Catholic theology.² Yet, they transcend Catholic Christianity. They can help evaluate the responses of the American trade empire to China's currency policy, which is the essence of this article.

To the Ancient Greeks and Romans, prudence, moderation, courage, and justice were virtues of the gods and goddesses for men and women to imitate. Arguably, the virtues are originally from Plato's *Republic*.³ In Protestant Christianity, these virtues emanate from the text of the New Testament itself and are manifest in the life of Christ. To live the Beatitudes demands fortitude and righteousness.⁴ The Parable of the Talents (or Ten Gold Coins) teaches prudence.⁵ The Parable of the Prodigal Son is a story not only about forgiveness but also about moderation.⁶

In Islam, they are laudable, even indispensable, if a Muslim is to submit to the will of Allah. Prudence is illustrated by Allah instructing the Prophet Muhammad (Peace Be Unto Him) to "call people to the way of your Lord with wisdom and beautiful teaching."⁷ Few pillars of any faith demand as much moderation from everyday practitioners as does adherence to the fast of Ramadan.⁸ Mercy (*rahmah*) towards wrongdoers is divine, but it takes

² As one catechetical source explains: "... The four chief moral virtues ... are those we call the cardinal virtues: prudence, justice, fortitude [ie, courage] and temperance [ie, moderation]" (Leo J. Triese, *The Faith Explained* (Manila: Sinag-Tala Publishers, Inc, 1991, Philippine edn) 115. These Virtues are defined in a variety of other catechetical sources.

³ Book I of the *Republic* is a Socratic dialogue on justice. Later in the *Republic*, Plato explains that within each individual, there are three souls, each of which relies on a virtue to operate successfully. The rational soul is our thinking dimension. Wisdom helps us distinguish the real from the false, and make reasoned decisions. The spirited soul, which is our active life, requires courage to do carry out what our rational soul determines the best conduct. The appetitive soul is our dimension of feelings. Moderation tempers our emotions and desires, helping us regulate our passions and defer gratification to act courageously in accordance with reason. When all three souls inter-relate in a harmonious manner, the individual – argues Plato – is just. See Plato, *Republic*, Book IV, 436b–443d, in S. Marc Cohen et al (eds), *Readings in Ancient Greek Philosophy: From Thales to Aristotle* (translated by G.M.A. Grube, Hackett Publishing Co, 2nd edn, 2000). Plato also presents his theory on justice and the cooperative effort of the three souls in the dialogue *Phaedrus*. See Plato, *Phaedrus* (translated by Robin Waterfield, Oxford University Press, 2002).

⁴ See The Gospel According to Matthew, Ch 5, verses 3–10. The Beatitudes are, of course, revealed by Christ in The Sermon on the Mount, in which Jesus instructs on blessed behavior pleasing to God.

⁵ See The Gospel According to Matthew, Chapter 25, verses 14–30; The Gospel According to Luke, Ch 19, verses 11–27. In this Parable (Luke's version), the good servant earns 10 additional gold coins off of his initial allotment from his nobleman master of one coin, and – having been prudent (and faithful) in a small matter – is given charge by the master of 10 cities. The wicked, lazy servant is one who failed to put the one gold coin with which his master entrusted him into a bank to earn interest, but rather kept it hidden in a handkerchief.

⁶ See The Gospel According to Luke, Ch 15, verses 11–32. Easily among the most famous of Parables, and depicted in Rembrandt's *The Return of the Prodigal Son* (c. 1668–1669), the lost son who squandered his share of the estate on wine, women, and song is nevertheless welcomed back tenderly and with celebration by his father, who longed for his return.

⁷ The Qur'an, *Surah* 16, *Ayat* 125 (translated by M.A.S. Abdel Haleem, Oxford University Press, 2004).

⁸ Moderation is further championed (*inter alia*) in *Surah* 16, *Ayat* 125-126: "Argue [Prophet (Peace Be Unto Him)] with them in the *most courteous way*, for your Lord knows best who has strayed

courage to forgive and thereby not impose a *Quran'ic* (*hadd*) punishment. Justice towards the underprivileged, and empathy with them, is a key reason for the *zakat* tax paid towards the end of Ramadan. In Buddhism, the four cardinal virtues (while certainly not dubbed as such) are noble. They are part of the Eight-fold Path.⁹ In brief, prudence, moderation, courage, and justice may be universal criteria by which to assess the behaviour of people toward each other.

The same criteria can be used to evaluate the behaviour of peoples – that is, communities, and nations – toward each other.¹⁰ Not infrequently, righteous community or political leaders champion the behaviour of their group or country, or condemn that of another, in language that (explicitly or implicitly) draws on the Four Cardinal Virtues. Mahatma Gandhi and Nelson Mandela did so with great success in leading, respectively, the Quit India movement and Anti-Apartheid campaigns. Today, the Iraq War and the Palestinian–Israeli conflict provide contexts, about which the American media obsess, for righteous, and sometimes self-righteous, discourse. Put simply, values – including religiously-premised ones – are part of the discourse of our times.¹¹ Is there not today a deep-seated concern, in America

from His way and who is rightly guided. If you [people] have to respond to an attack, *make your response proportionate*, but it is best to stand fast.” The Qur’an (translated by M.A.S. Abdel Haleem, 2004) (emphasis added).

⁹ The Four Noble Truths are enabling insights, namely, (1) life ultimately is unsatisfactory and consists of suffering, (2) this situation is caused by material craving, which if continued leads to reincarnation, (3) the cycle of birth–death–re-birth can be transcended, and *Nirvana* achieved, by destroying craving, (4) the Eight-fold Path provides the route for transcendence. That Path consists of (1) right view or understanding, (2) right resolve, (3) right speech, (4) right action, (5) right livelihood, (6) right effort, (7) right mindfulness, and (8) right concentration or unification. The analogies between prudence, moderation, courage, and justice, on the one hand, and several features of the Path, on the other hand, are evident. See Peter Harvey (ed), *An Introduction to Buddhist Ethics* (Cambridge University Press, 2000), 31–33, 37–39. See also *ibid.*, 39–40 (concerning Noble persons, namely, those people “who have been permanently changed, to some degree, by insight into *Dhamma*”, ie, eternal truths and cosmic law-orderliness).

¹⁰ There is, of course, a long tradition in international relations theory, and a vast literature in that discipline, on realism and idealism. A discussion of those two schools (especially Wilsonian idealism), and the relationship of the present thesis to them, is beyond the scope of this article. See Woodrow Wilson, *International Ideals: Speeches and Addresses made during the President's European Visit*, 14 December 1918 to 14 February 1919 (Harper, 1919). For a thorough overview of the development of Wilsonian idealism in 20th century America, see David Steigerwald, *Wilsonian Idealism in America* (Cornell University Press, 1994).

¹¹ Academics, including professors at US law and business schools, are part of and contributors to this discourse. For example, Professor Timothy A. Canova, the Director of the Center for Global Trade & Development at Chapman University School of Law, explores values implicated by war. He compares values prevailing in the United States today to values dominant in the era of the Second World War and Cold War. See Timothy A. Canova, “American Wartime Values in Historical Perspective: Full-Employment Mobilization or Business As Usual”, (fall 2006) *ILSA Journal of International and Comparative Law* 13, 3–23. Harvard Business School Professor Rosabeth Moss Kantor identifies 6 opportunities for becoming a can-do nation again in her book *America the Principled* (Crown, 2007). Among her inquiries (in Ch 3, concerning growing good companies), is whether values-based capitalism can replace imperial excess. What is less common among academics is explicit invocation of Christian teaching as a basis for argumentation. Indeed, Professor Kantor mentions the Catholic Church just twice in her book (pp 149 and 159), and then only

and abroad, that the United States might somehow have lost its moral anchor in how it engages the world?¹² Indeed, is it not also true that China is being analysed – from outside and even within – using a moral compass?

In American history, value discourse is hardly an aberration, though ugly episodes in its history bespeak risks of preachy zealotry and contagious prejudice. From the earliest days of the Republic, and even before, in the fiery political sermons of Jonathan Edwards (1703 to 1758),¹³ Americans have spoken of normative characteristics that make the United States a unique, shining city on a hill. Many of their leaders exhort and inspire them to manifest, or better manifest, certain virtues. Rightly suspicious of excessive or hypocritical moralising, most in the mainstream of the American political economy consider and contribute constructively to a value-rich civic discussion, even if a consensus on applying specific values in particular contexts proves elusive.

Much of America no longer looks quite like a Norman Rockwell painting, but what properly schooled American does not cherish the prudence of Ben Franklin,¹⁴ the moderation of Abraham Lincoln,¹⁵ the courage

in the negative (namely, to mention in passing the of course regrettable and damaging sex abuse scandal). The secular predisposition of the mainstream academy may reflect (1) ignorance or deliberate neglect of 2,000 years of Christian thinking about values as they relate to the behaviour of nations, (2) a bias in favour of philosophical work founded on reasoned (and ostensibly objective) argumentation rather than theological work that draws strength from both reason and (and ostensibly unverifiable) revealed truth, and (3) lingering prejudices in favour of the secular and against religion (sometimes catalysed by historical abuses committed in the name of religion).

¹² It surely has lost considerable power, authority, and prestige, which have limited its ability to deal with international crises, as a 2007 study by Britain's independent International Institute for Strategic Studies reveals. See Stephen Fidler, "US Suffers Decline in Prestige, Reveals Survey", *Financial Times*, 13 September 2007, at 5.

¹³ See Philip F. Gura, *Jonathan Edwards – America's Evangelical* (Hill and Wang, 2005) (chronicling the life and evangelical theology of the 18th century clergyman).

¹⁴ Among his many remarks about prudence, Benjamin Franklin wrote in an essay entitled "The Busy-Body," published in *Weekly Mercury* on 18 February 1728: "It is said that the Persians, in their constitution, had public schools in which virtue was taught as a liberal art or science; and it is certainly of more consequence to a man that he has learnt to govern his passions in spite of temptation, to be just in his dealings, to be temperate in his pleasures, to support himself with fortitude under his misfortunes, *to behave with prudence in all his affairs and circumstances of life*; I say, it is of much more real advantage to him to be thus qualified, than to be a master of all the arts and sciences in the world besides." (Emphasis added.) Quoted in Benjamin Franklin, "The Art of Virtue", in Nathan G. Goodman (ed), *Life of Benjamin Franklin* (University of Pennsylvania Press, 1938) 19. This quote is re-published in a variety of online sources, including on <http://www.choiceskill.com>. See also George L. Rogers (ed), *Benjamin Franklin's The Art of Virtue: His Formula for Successful Living* (Acorn Publishing, 3rd edn, 1996) (for more details on Franklin's life and work).

¹⁵ On 4 March 1865, at his Second Inaugural Address, President Lincoln called for moderation in victory over the Confederacy in the Civil War: "... It may seem strange that for any men should dare to ask a just God's assistance in wringing their bread from the sweat of other men's faces, but let us judge not, that we be not judged. The prayers of both could not be answered. That of neither has been answered fully. The Almighty has His own purposes. 'Woe unto the world because of offenses; for it must needs be that offenses come, but woe to that man by whom the offense cometh.' ... With malice toward none, with charity for all, with firmness in the right as God gives us to see the right, let us strive on to finish the work we are in, to bind up the nation's wounds, to care for him who shall have borne the battle and for his widow and his orphan, to do all which may achieve and cherish a just and lasting peace among ourselves and with all nations."

of Franklin Roosevelt,¹⁶ and the justice of the Great Chief Justice, John Marshall?¹⁷ Rhetoric and reality do not always exist in an unproblematic relationship. Thus, was it not Martin Luther King who challenged Americans to live up to its principles, declaring: “If we are to go forward, we must go back and rediscover those precious values – that all reality hinges on moral foundations and that all reality has spiritual control?”¹⁸ In brief, prudence, moderation, courage, and justice are values dear to most Americans, regardless of their background or faith.

International trade and American foreign economic policy is no stranger to this discourse.¹⁹ The energy crisis and America’s dependence on the Middle East for oil was, as President Jimmy Carter declared on 18 April 1977 the “moral equivalent of war.”²⁰ China is not a strange context for this kind of discourse. From environmental rights to labour and human rights, Americans – both officials inside the Washington, DC, beltway, and in the Heartland – are anxious about their business dealings with the Middle Kingdom. In the run-up to China’s WTO accession (which occurred effective 11 December 2001), they debated whether China should be awarded permanent normal trade relations (PNTR), given its record on religious freedom, the Three Gorges Dam, prison labour, and an array of other matters of importance to what President Thomas Jefferson declared should be an “Empire of Liberty,”²¹ and an “Empire for Liberty.”²²

Today, there is one context involving China in which the language of virtue could be – yet, has not been – applied: the dispute between the

¹⁶ In his First Inaugural Address to Congress on 4 March 1933 announcing a New Deal, President Roosevelt declared “The only thing we have to fear is fear itself.”

¹⁷ For instance, in *McCulloch v Maryland*, Chief Justice Marshall wrote: “Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional.” 17 US 316, 4 Wheat 316, 4 L Ed 579 (1819).

¹⁸ Quoted in Alex Ayres (ed), *The Wisdom of Martin Luther King, Jr* (Meridian Publishers, 1993) 156 (quoting *The Trumpet of Conscience* (New York: Harper & Row, 1967) at 75). This quote is republished in a variety of online sources, including <http://www.brainyquotes.com>.

¹⁹ See generally Douglas A. Irwin, *Against the Tide* (Princeton, NJ: Princeton University Press, 1996) (reviewing the history of the idea of free trade and its moral implications).

²⁰ Quoted in President’s Address to the Nation on the Energy Problem, 1 Published Papers 656 (18 April 1977). In this speech, Carter quoted William James, who used the phrase in his essay titled *The Moral Equivalent of War*.

²¹ On 25 December 1780, Jefferson wrote to George Rogers Clark: “... we shall form to the American union a barrier against the dangerous extension of the British Province of Canada and add to the Empire of liberty an extensive and fertile Country thereby converting dangerous Enemies into valuable friends.” Julian P. Boyd (ed), *Papers of Thomas Jefferson* (Princeton University Press, 1951), Vol 4, pp 237–238.

²² On 27 April 1809, Jefferson wrote to James Madison: “We should then have only to include the north in our Confederacy, which would be of course in the first war, and we should have such an empire for liberty as she has never surveyed since the creation.” Andrew A. Lipscomb and Albert Ellery Bergh (eds), *The Writings of Thomas Jefferson*, (Washington, DC: Thomas Jefferson Memorial Association of the United States, 1903–1904), Vol 17, p 277. This quote is available on various online sources, including <http://www.monticello.org>.

United States and China over the relative foreign exchange valuation of the yuan, or renminbi (RMB),²³ against the dollar. American exporters, along with critics of China, argue the yuan is undervalued against the dollar by 15 to 40 per cent.²⁴ This article does not quarrel with their argument. Let the points be conceded readily now: the Chinese currency indeed is undervalued substantially relative to the dollar, this misalignment contributes to the bilateral trade deficit with China, and revaluation of the yuan would help re-balance the trade relationship.

This article is not about China or the Chinese. It is about America and its trade empire, about American reactions to China and the Chinese. What does the dispute, and America's responses to it, say about the American character and values Americans hold dear? This inquiry – does America apply virtues Americans cherish to a problem its trade empire faces? – motivates the present article.

There is no more important trade controversy between the United States and China than foreign exchange, though other topics – the enforcement of intellectual property rights (IPRs) and sanitary and phytosanitary (SPS) measures – rightly command considerable attention. Nonetheless, the yuan-dollar dispute will be settled eventually, via one legislative or policy manoeuvre or another. When the histories of the modern American trade empire are written (and by no means is this article pre-disposed to see them penned in the near future) some specific battles – over beef hormones, bananas, foreign sales corporations, softwood lumber, aircraft subsidies, zeroing in dumping margin calculations, and China's currency valuations – will be of considerable technical importance. On their own, however, what lessons will they teach that will loom larger than, and endure beyond, technicalities? What will they say to future generations of trade practitioners, scholars, and students, in the United States and abroad?

It is the purpose of this article to consider currency valuation in the light of the Four Cardinal Virtues. Succinctly put, the thesis here is that the China currency dispute reveals a lack of virtue in the manner in which America presides over its trade empire. Far from displaying the Four Cardinal Virtues in the way it responds to alleged yuan undervaluation, the United States displays their opposites or near-opposites: imprudence, gluttony, irresolution, and unfairness. It could well be that the China currency battle reveals a schism between America's stated principles and its engagement with the world.

²³ "Ren min bi" literally means "people's money."

²⁴ See Amy Tsui, "Senate Debate on Currency Bills, China yuan Affected by Doubts About WTO Compliance", 24 *International Trade Reporter* (BNA) 1260-1262 (6 September 2007). If the yuan is valued in trade-weighted terms, then the estimate of its undervaluation is enlarged.

At this juncture of its short history, the American trade empire is one dimension of its larger economic empire, finance and investment being the other dimensions, and all three dimensions interacting with one another.²⁵ In turn, its economic empire is closely related to – sometimes leading, sometimes following, but once established, sustained by – its vast political and military empire. All told, the result is – to use the brilliant title of Professor Niall Ferguson’s provocative book – a colossus.²⁶ The scope and scale of what is at stake are too grand to use euphemisms like “interests” or academic jargon like “hegemonic.” Call a spade a spade, urges Professor Ferguson.²⁷

²⁵ The economic–imperial genre has a long and rich tradition in American academic discourse. For example, William Appleman Williams, the famous radical historian on the New Left, at the University of Wisconsin – Madison, and the “Wisconsin School” interpreted American foreign policy and international law through the lens of American economic self-interest. See eg, William Appleman Williams, *The Tragedy of American Diplomacy* (New York: W.W. Norton & Company, 1998); *Empire as a Way of Life: An Essay on the Causes and Character of America’s Present Predicament Along with a Few Thoughts About an Alternative* (New York: Oxford University Press, 1980). On the life and thought of Professor Williams, see Paul Buhle, *William Appleman Williams: Learning from History* (New York: Routledge, 1995). For economic interpretations of American policy toward China, including the Open Door Policy, see eg, Thomas J. McCormick, *China Market: America’s Quest for Informal Empire, 1893–1901* (Chicago: Ivan R. Dee Publishers, 1990). See generally Ronald Findlay and Kevin H. O’Rourke, *Power and Plenty: Trade, War, and the World Economy in the Second Millennium* (Princeton, NJ: Princeton University Press 2007) (arguing that for most of the last 1,000 years, “the pattern of trade can only be understood as being the outcome of some military or political equilibrium between contending powers,” and trade liberalisation typically has occurred because of “the barrel of a Maxim gun, the edge of a scimitar, or the ferocity of nomadic horsemen”). This genre harkens back to another tradition, namely, revisionist argumentation that the American Constitution itself was founded less on grand principles of liberty, and more on the individual economic interests of the Founding Fathers. See Charles A. Beard, *An Economic Interpretation of the Constitution of the United States* (Dover Publications, 2005) (original edn 1913).

²⁶ See Niall Ferguson, *Colossus – The Price of America’s Empire* (New York: The Penguin Press, 2004).

²⁷ America remains in denial about the propriety of the rubric “empire,” and the reality underlying it, as Professor Ferguson argues forcefully in *Colossus* (*ibid.*). This article accepts the Ferguson thesis. For a different view, namely, an argument that “empires” of old have disappeared but nothing (other than “hegemonic” powers) has replaced them, see eg, Eric Hobsbawm, *Globalisation, Democracy and Terrorism* (Little, Brown, 2007), Chs 3, 10. This argument rests on the conventional premise that an empire seeks to acquire and hold territory. That conventional assumption yields a narrow definition of “empire.” Moreover, as Professor Ferguson points out, America indeed has conquered and held territory – Hawaii being just one example, others being the American Samoa, Guam, Philippines, and Puerto Rico, and the very conquest of the western frontier from Native American lands being still another illustration. Military bases around the world – from Iceland to Qatar – are yet more physical manifestations of empire. As of 2005, the United States has 737 military bases overseas. See US Department of Defense Base Structure Report, available at http://www.defenselink.mil/pubs/20050527_2005BSR.pdf. The exact number of countries across which these bases exist is not readily obtainable, and may well be classified for national security purposes. However, it may be reasonable to assume the number could be 100 or more countries.

Thus, a modern definition accommodates the exercise of power and influence through a variety of modalities aside from raw acquisition and control of land. Those modalities include military, economic, and cultural might. In respect of the United States, consider, for instance, the facts that:

- *Population* – With approximately 301 million people (as of July 2007), America is the third most populous country in the world, bested only by China (1.2 billion) and India (1.1 billion). See CIA World Factbook (2007 edn), available online at <http://www.cia.gov>.
- *Defence Spending* – America’s defence budget is the largest in the world. It is (projected for 2007, not accounting for supplemental appropriations that may be requested for Iraq or other

engagements) US\$439.3 billion, out of a total budget of US\$2.770 trillion, ie, defence accounts for 16% of federal expenditures. See <http://www.whitehouse.gov/omb/budget/fy2007/defense.html>. Remarkably, according to one internet-based source, in 2006 the American defence budget was US\$518.1 billion, which far exceeds the combined defence expenditures – about US\$300 billion – of the following 13 major countries: (see <http://www.globalfirepower.com>).

Country	Amount (US\$, in billions, rounded, highest to lowest)
China	81.5
France	45
Japan	44.3
United Kingdom	42.8
Germany	35.1
Korea (South)	21.1
India	19
Kingdom of Saudi Arabia	18
Russia	18
Brazil	9.9
Israel	9.5
Korea (North)	5.2
Iran	4.3

- *Economic Output* – America (as of 2006) has an annual Gross Domestic Product (GDP) of approximately US\$13.6 trillion, the largest in the world, and roughly accounting for one-quarter of all world output, and a per capita GDP of US\$43,800. See CIA World Factbook (2007 edn), available online at <http://www.cia.gov>.

- *Advanced Education* – American colleges and universities are the envy of many in the world, not only for their general excellence in teaching, but also for their leadership in research. Indeed, 6 of the top 10 universities in the world are located in the US. See David Turner, “US and England Top University Rankings”, *Financial Times*, 8 November 2007, available online at <http://search.ft.com/ftArticle?queryText=us+universities&aje=true&id=071108000200&ct=0>.

- *Cultural Influence* – American movies, television programmes, and music are distributed globally (through lawful and unlawful means), and are enjoyed (and criticised) in every city, town, and village where they are available. It may come as a shock that the all-time top box-office film in France, the birthplace of “culture” and a famous hotbed for anti-Americanism, is the 1995 Hollywood blockbuster, “Titanic.” See “Spot the Difference”, *The Economist*, 20 December 2005, available online at http://www.economist.com/world/europe/displaystory.cfm?story_id=E1_VPNPSGN. As of 2 February 2008, 3 of the top 5 songs on the Billboard’s European Hot 100 singles were performed by American artists (namely, Timbaland, Rihanna, and Alicia Keys). See Billboard European Hot 100 Singles, http://www.billboard.com/bbcom/charts/chart_display.jsp?g=Singles&f=European+Hot+100+Singles (last visited 2 February 2008).

- *Brand Names* – The US is home to several companies boasting global brand names, including Apple, Google, McDonald’s, Nike, and Starbucks. The Coca-Cola brand has long been the most valuable: experts estimate this brand is worth between US\$79 billion and US\$119 billion. See Jennifer Hughes, “Intangibles: Why it is Hard to Value a Mystery”, *Financial Times*, 4 January 2008, available online at <http://www.ft.com/cms/s/0/c249cc24-ba74-11dc-abcb-0000779fd2ac.html>.

- *Diplomatic Power* – By all anecdotal accounts, America exerts a unique influence in international organisations, especially the United Nations, World Trade Organization (WTO), World Bank, International Monetary Fund (IMF), and regional developments. It holds, for instance, 17% of shares in the IMF, and with that bloc an effective veto. This is possibly a diminished influence in comparison with the 1950s.

- *Military Reach* – American military might has long been one of the greatest strengths of the US, though its controversial use arguably has become one of its greatest weaknesses. This military includes an Air Force, an Army, a two-ocean Navy, and several special operations forces. It currently is engaged in two wars, in Afghanistan and Iraq, and potentially capable of handling a third (albeit limited, low-intensity) front. As of December 2007, America had over 1.4 million men

America's commercial intercourse with other nations attracts less attention in the popular media than its well-chronicled overseas political and military blundering. Though generosity is missing among them, the principles supporting America's trade empire are high-minded, even noble: comparative advantage, open markets, wealth creation, and even peace through trade.²⁸ Yet, like some of the 70 empires in human history, the American empire may wither or collapse for reasons largely or principally related to commerce.²⁹

The ability of the American trade empire to withstand external challenges, which may reveal internal structural weaknesses, is no better tested than by China. The Middle Kingdom, of course, is the leading candidate, with dynamic India in second place, and a confused EU a distant third, to establish the next great trade empire. Sadly, America's failure to put into practice any of the Cardinal Virtues in dealing with the leading trade challenge from China may be a self-inflicted wound to its long-term imperial interests. Might a lack of rectitude be one internal factor, which, when manifest in international economic relations, contributes along with exogenous economic forces to imperial decline or collapse? It is a question the China currency dispute ought at least to prompt.

Section 2 of this article explains the economic challenges posed by the yuan-dollar rate. Section 3 explores China's money trap and employment problem, and in so doing suggests that American pressure for dramatic, quick yuan revaluation is thoughtless. Section 4 discusses the bilateral trade deficit, showing the lack of moderation in American consumptive behaviour, as well as the immoderation of demanding revaluation as a way to deal with the deficit. Taken together, Sections 2 to 4 deal with economic aspects of yuan undervaluation. The remainder of the article focuses on the legal dimensions of the topic. Section 5 reviews the failure of the United States to test plausible legal bases for addressing China's alleged undervaluation, namely, Article XV:4 of the General Agreement on Tariffs and Trade

and women in active duty. See Department of Defense Active Duty Military Personnel, available online at <http://siadapp.dmdc.osd.mil/personnel/MILITARY/rg0711.pdf>. In 2005, American military expenditures accounted for 4.06% of US GDP. See *Military Expenditures – Percent of GDP*, CIA Factbook (2007 edn), available online at <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2034rank.html>.

²⁸ On generosity, see eg, Raj Bhala, "The Limits of American Generosity", 29 *Fordham International Law Journal* (January 2006) 299–385. On the other principles, see eg, Raj Bhala, *International Trade Law: Interdisciplinary Theory and Practice* (LexisNexis, 3rd edn, 2008) Chs 1–10. Concerning latent solidarity among people triggered by actual human contact, see eg, Paolo Carozza, "Subsidiarity as a Principle of International Human Rights Law", (2003) 97 *American Journal of International Law* 38. Such contact can bring with it the recognition of common interests, and then catalyse the creation or refinement of institutions designed to facilitate coordinated action.

²⁹ The calculation of the number of empires – 70 being the most generous figure, including both communist China (#69) and the European Union (EU) (#70) – in history comes from the *Times Atlas of World History*, as referred to in Ferguson (n 26 above).

(GATT) and Article 3 of the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM Agreement). This failure, Section 5 urges, bespeaks a lack of courage. Section 6 considers why America's handling of the issue is unjust. Legislative initiatives have not articulated a standard for proper currency alignment, but have toyed with illegal tariff surcharges, sought unilaterally to expand the scope of countervailing duty (CVD) rules, and sought – again unilaterally – to change the rules on dumping margin calculations in antidumping (AD) investigations.

Section 7 offers concluding thoughts, including a perspective from the American Heartland – Kansas. On balance, the responses of the American trade empire to the challenge of the Chinese yuan seem to merit barely passing marks in respect of prudence and courage, and failing grades on moderation and justice. This evaluation is advanced as a proposition, not intended as a judgmental imposition. Assigning marks is intended to provoke questions for thought and debate, not impose dark or definitive conclusions.

2. The Challenge to Empire

For a decade, 1995 to 2005, the People's Bank of China (PBOC), the central bank of the country, maintained a fixed exchange rate of the yuan to the United States dollar. It set the yuan-dollar peg at 8.2800 yuan per dollar.³⁰ Whenever American importers sold dollars to buy yuan, and in turn

³⁰ Technically, the PBOC established a band of RMB 8.2760–8.2800 per dollar. See Richard McGregor and Steve Johnson, "Rumours of Renminbi Revaluation Intensify", *Financial Times*, 30 April–1 May 2005, at 1. Nearly so, but not invariably, the PBOC maintained that band. For instance, for approximately 20 minutes on 29 April 2005, the yuan traded at a higher level than the band – RMB 8.2700 per dollar. The State Administration for Foreign Exchange (SAFE) conducts foreign currency trading for the Chinese government, and it was uncertain whether its transactions were conducted at the higher rate. The PBOC ascribed the event to "technical problems," yet foreign exchange traders speculated China was testing the market to see what measures it would need to take to revalue the yuan in an orderly manner – which it did days later. See *ibid.*; Richard McGregor, "China Currency Trades Briefly Outside Set Band", *Financial Times*, 30 April–1 May 2007, at 2.

What is a "peg" in comparison with other exchange rate regimes? Every September, the IMF publishes a lengthy Annual Report on Exchange Arrangements and Exchange Restrictions, which lists 9 categories of regimes. At one extreme, the freest system is an independently floating exchange rate. Japan, the US, and other major countries use this system. At the other extreme, the tightest system is one in which a country adopts the US dollar as its currency. Ecuador and El Salvador are examples. In between these poles is a "conventional pegged" currency. A peg exists in one of two instances: (1) an exchange rate is allowed to fluctuate in a narrow band of plus or minus 1%, or (2) the maximum or minimum value of that rate is constrained narrowly to a 2% margin for at least 3 months. Until the July 2005 yuan revaluation, the IMF classified China – along with the Kingdom of Saudi Arabia, Venezuela, and several other countries – as having pegs. For the IMF to reclassify the yuan as a managed floating currency, which is another category between the poles, towards the freest end, China must permit the yuan to fluctuate beyond these slim bands. See Brett Ferguson, "yuan Must Move 2 Percent in 3 Months for China to Lose 'Pegged Currency' Label", (4

used the yuan to pay Chinese exporters for merchandise, the ineluctable market result was upward pressure on the price of the yuan (the currency bought) relative to the dollar (the currency sold). To keep the rate pegged, the PBOC intervened in the market (directly or through intermediaries) and counteracted the pressure: it would buy dollars and sell yuan, thereby exerting offsetting pressures.³¹

For many years, the United States has complained the level is undervalued, that the yuan truly is worth more against the dollar, and thus China manipulates its currency to obtain an unfair trade advantage. Hence, Chinese authorities should revalue the yuan by a considerable amount, if not allow it to float freely and appreciate in accordance with underlying economic fundamentals in the Chinese and American economies.³² As *The Economist* succinctly surmised, “American politicians *bash* China for its policy of keeping the yuan weak.”³³

Persistent undervaluation of the yuan, American authorities allege, artificially stimulates Chinese trade to the United States, and it reduces the opposite flow. An unfairly cheap yuan relative to the dollar stimulates Chinese exports to the United States. Assuming Chinese exports are invoiced in yuan, Americans could convert dollars into a larger number of yuan than if the yuan were aligned properly, and thereby purchase Chinese products. Conversely, the unfairly cheap yuan depresses American exports to China. Chinese consumers receive fewer dollars per yuan, because of the unfairly cheap yuan, and thus have less dollar purchasing power with which to buy American products (assuming dollar invoicing of those exports).³⁴

August 2005) 22 *International Trade Reporter* (BNA) 1284–1285.

³¹ See Greg Mankiw, *The Mechanics of a Fixed Exchange Rate*, 28 May 2006, available at <http://gregmankiw.blogspot.com/2006/05/mechanics-of-fixed-exchange-rate.html> (explaining the mechanics of the yuan–dollar peg).

³² “Revaluation” (and its opposite, “devaluation”) refers to an official governmental act (or set of measures) to increase (decrease) the value of its currency against one or more foreign currencies. “Appreciation” (and its opposite, “depreciation”) refers to market-driven phenomenon of an increase (decrease) in the relative value of a currency as a result of purchases and sales, and their impact on supply and demand, by private parties.

³³ “Sizzling”, *The Economist*, 7 July 2007, at 74. Not all American politicians, of course, are like-minded on this issue, or on trade policy generally. A refreshingly candid – and courageous – remark came from Senator John McCain (Republican–Arizona), who declared on the presidential campaign trail: “All I can tell you is I’m a free trader, so I’m not your candidate. I’m sorry, but I’m not.” Quoted in “Primary Color”, *The Economist*, 17 November 2007, at 38 (citing “John McCain Fails to Pander to the Masses”, *The Boston Globe*, 9 November 2007).

³⁴ As one among many anecdotal stories, an American manufacturer of automotive parking-brake cables reports a US\$4.50 sale price for its product in the US, yielding a 35 cent per unit profit. The price at which it could sell the cables in China is US\$3.75. Were the yuan to appreciate to an appropriate level against the dollar, as have the pound sterling and euro, the selling prices in the two markets would be about equal, US\$4.50, and the company would be competitive in both. (With a cheaper dollar relative to the yuan, the company’s price of US\$4.50 would translate into fewer yuan than before revaluation, making that price affordable in China. For example, at 8.28 yuan per dollar, the US\$4.50 price is 37.26 yuan. If the yuan appreciates to 7.61 yuan per dollar, then US\$4.50 translates into 34.25 yuan.) However, the US\$3.75 selling price in China is below

Other benefits unfairly accrue to China because of the undervalued yuan. Undervaluation stimulates foreign direct investment (FDI) flows out of the United States and into China, by reducing the relative costs of purchasing Chinese assets (such as property, plant, equipment) and employing factors of production (especially labour), and by adding certainty and predictability to business planning in respect of exchange rate conversion. Further, Chinese coffers fill up with tax revenues from profitable exporters, whereas the opposite occurs in the United States.

On 21 July 2005, the PBOC “bowed to intense foreign pressure and growing domestic economic imbalances” by revaluing the yuan.³⁵ The PBOC took five specific steps:

- It revalued the yuan by 2.1 per cent, to 8.11 yuan per dollar.
- It abandoned the peg to the dollar.
- It linked the yuan value to a reference basket of currencies, though it did not identify the exact currencies or their weightings in the basket.
- It set a band for the yuan value, saying the yuan could fluctuate up or down in daily trading by 0.3 per cent.
- It committed itself to managing tightly the yuan within the narrow band.

Since the revaluation, the yuan has appreciated by over nine per cent against the dollar, reaching a zenith on 10 July 2007 of 7.56.³⁶ The yuan breached that high point in the fall 2007, equalling roughly US\$7.43. By February 2008, China had permitted a further modest revaluation, to approximately 7.2 yuan per dollar, or a rise of about 4.8 per cent since 10 July 2007, or a total of nearly 16 per cent since the eve of revaluation.³⁷

the company’s cost of production in the US, making it unprofitable for the company to export to China (or compete with lower-cost Chinese companies) See Peter S. Goodman and Paul Blustein, “China’s Export Engine; International Competitors Crying Foul Over Cheap Currency”, *The Washington Post*, 13 September 2006, at D1. Interestingly, the yuan reached 7.6132 per dollar, on 30 June 2007. See “yuan at Highest Point Since Revaluation”, *International Herald Tribune* (Hong Kong edn), 30 June–1 July 2007, at 14.

³⁵ Richard McGregor, Edward Alden, Andrew Balls and John Burton, “China Revalues the Renminbi”, *Financial Times*, 22 July 2005, at 1.

³⁶ See Joseph Kahn, “Trade Surplus for China Hits Record \$26.9 Billion”, *International Herald Tribune* (Hong Kong edn), 11 July 2007, at 1; Cary Huang and Denise Tsang, “Tax Rebate Cuts Tipped to Slow Export Growth”, *South China Morning Post*, 12 July 2007, at B4. Curiously, the same newspaper reported two figures as the 10 July 2007 high – 7.5656 yuan per dollar, and 7.5631 yuan per dollar. See *ibid.*, and Guo Aibing, “Record Forex Reserves Keep Heat on yuan”, *South China Morning Post*, 12 July 2007, at B8.

³⁷ In trade-weighted terms, the appreciation of the yuan is considerably less, only 5% between the July 2005 revaluation and year-end 2007. See “Revaluation by Stealth”, *The Economist*, 12 January 2008, at 69.

China's move to a tightly managed floating exchange rate regime did little to pacify the United States, despite the characterisation in the international media of the shift as "a victory for the administration of President George W. Bush,"³⁸ and "a personal triumph for [Treasury Secretary] Mr [John] Snow."³⁹ Seeming to ignore the new valuation benchmark of a currency basket, the economic justification for using a basket, and the resemblance of China's new regime to that of Singapore, the United States Department of the Treasury said it expected China would allow the yuan to appreciate by 0.3 per cent against the dollar specifically.⁴⁰ The Treasury intoned it would monitor the extent to which the PBOC allowed market supply and demand conditions, and underlying economic fundamentals, to determine the exchange rate.⁴¹

Congress damned the July 2005 revaluation with faint praise. Senator Charles Schumer (Democrat–New York), remarked: "It is smaller than we had hoped, but to paraphrase the Chinese philosophers, a trip of a thousand miles can begin with the first baby step." The paraphrase was subtly self-serving. The adage, found in the *Tao Te Ching* by Lao Tzu, and deployed by (*inter alia*) Chairman Mao Zedong, affirms that a long journey not only can, but must, begin with one, single – not merely baby – step.⁴²

³⁸ Richard McGregor et al, n 35 above, at 1 (emphasis added).

³⁹ Andrew Balls and Alan Beattie, "US Treasury Welcomes Currency Reform", *Financial Times*, 22 July 2005, at 2 (emphasis added).

⁴⁰ Pegging the value of a currency to a basket of other currencies reduces the vulnerability of the pegged currency to changes in the value of any single currency in the basket. See Francesco Caramazza and Jahangir Aziz, "Fixed or Flexible? Getting the Exchange Rate Right in the 1990s", International Monetary Fund, 13 *Economic Issues* 8 (1998).

⁴¹ See Richard McGregor et al, n 35 above, at 1 (quoting Treasury Secretary John Snow and other senior officials).

⁴² The phrase and its background appear on many internet website compilations of quotations. See, eg, <http://www.thinkexist.com>. In Pinyin, the proper transliteration of the title is *Dao De Jing*. One common observation of trade officials and scholars in foreign countries is the admixture of arrogance and hypocrisy manifest in remarks by some of their American counterparts. Trade controversies generate heated rhetoric, but new temperature thresholds seem to be breached by the American side, with counterproductive results. Take, for example, the characterization by United States Trade Representative (USTR), Susan Schwab, of the position of India's Minister of Commerce and Industry, Kamal Nath, as regards agricultural negotiations in the Doha Round: "inflexible" and "low ambition." Quoted in Heather Timmons, "Tough Talk from India on Spokesman on Trade", *International Herald Tribune* (Hong Kong edn), 14–15 July 2007, at 13. (A separate, but related, topic is the willingness of some American journalists to accept such one-sided characterisations, evident (*inter alia*) from the titles of their articles.) Minister Nath is one in a chorus of officials from developing and least developed countries, and non-governmental organisations (NGOs), to argue the issue "is removal of [farm] subsidies." Quoted in *ibid*. True or not, the characterisation does not befit a senior official representing the American trade empire, and holding the rank of Ambassador, and in any event is counterproductive to imperial interests – namely, achieving a successful conclusion to the Round. For an analysis of the matter, see Raj Bhala, *International Trade Law: Interdisciplinary Theory and Practice* (LexisNexis, 3rd edn, 2008), Ch 4.

3. Prudence and the Thoughtless Empire

If the Four Cardinal Virtues are to be the criteria by which the response of the American trade empire to the challenge of the Chinese yuan is evaluated, then a working definition of each virtue is needed. Moral certainty on topics in international law and political economy may be rare, and surely risks self-satisfied self-righteousness, but moral uncertainty is certain, and the spectre of radical indeterminacy imminent, without articulating clear normative standards.

What, then, is “prudence”? As one catechetical source explains:

“*Prudence* is the power to make right judgments. A person who is temperamentally impulsive, given to rash and unthinking action and snap judgments, will have a job to do in removing those obstacles before the virtue of prudence can operate in him effectively ...”⁴³

Put simply, prudence is careful thought before, and manifest in, action. A knee-jerk reaction, a failure to weigh causes and consequences or to foresee externalities, is its antithesis.

In turn, a hallmark of a prudently run trade empire is contemplation, free from jingoism, of challenges posed by trade measures – acts, policies, and practices – of other governments, and critical appraisal of alternative responses to those measures. How does America measure up to the virtue of prudence in handling yuan undervaluation? Do two major economic facts – concerning the Money Trap and Employment – call for assigning a low mark on prudence?

China’s Money Trap

“[The Chinese economy] is “unstable, unbalanced, uncoordinated and unsustainable.”

Chinese Premier Wen Jiabao⁴⁴

For several years, China has been in what economists dub a Money Trap with no obvious means of escape. The trap “consists of self-reinforcing structures in which cause and effect are intertwined,” and the “heart” of the trap is China’s trade surplus.⁴⁵ There are four steps in the trap.

⁴³ Leo J. Triese (n 2 above).

⁴⁴ Speech to National People’s Congress, March 2007 (quoted in Michael Pettis, “China’s Last Option: Let the yuan Soar”, (June 2007) 170 *Far Eastern Economic Review* No 5, 14).

⁴⁵ Michael Pettis, n 44 above, 10–11.

In Step One (the Trade Surplus), China maintains a persistently large, indeed growing, current account surplus (an excess of exports over imports). The surplus grows – albeit not with perfect consistency or precision. In Step Two (Foreign Currency Inflows), that surplus generates large inflows of hard currencies, as Chinese exporters receive payment for their wares in US and Canadian dollars, EU euros, Japanese yen, Swiss francs, and other currencies that are widely traded and accepted as a means of payment.

In Step Three (Foreign Exchange Reserve and Money Supply Growth), the exporters deposit their earnings in Chinese banks, and expect at least a portion thereof in local currency. In turn, the banks deposit at least a portion of the foreign capital with the PBOC, the central bank of the country. The PBOC issues local currency (or short-term central bank bills, a near-substitute for currency) to the banks. Critically, the result of Step Three is that foreign exchange inflows become official foreign exchange reserves held by the PBOC, and the local currency the PBOC spends for the reserves adds to the money supply of China. They are sufficient to cover 18 months worth of imports into China, a level above the prudent economic threshold of six to nine months, and far above the three month suggested minimum. The gargantuan reserves also mean China has more official reserves (at US\$1.33 trillion as of the end of June 2007) than any other country in the world, and they have increased dramatically and quickly.⁴⁶

In Step Four (Lending, Over-Investment, and Exportable Surpluses), sectors in which China already has over-invested get imprudently risky loans to expand their production and export capacities. The recipients of such loans tend to be state-owned enterprises (SOEs), many of which are or ought to be privatised, put on a commercially viable footing, or closed down. The result of this step, which manifests the vicious rather than virtuous cycle of the Money Trap, is higher industrial output, much of which is exported, resulting in yet more exports and current account surpluses. Additional untoward results are real estate and stock market bubbles, and inflation.⁴⁷

⁴⁶ *Ibid.*, and see n 36 above. China's foreign reserves as of March 2006 were an estimated US\$850 billion, meaning the increase from in just over 1 year (to June 2007) was 56.5%. See Edward Alden, Richard McGregor and Demetri Sevastopulo, "Mistrust and Mutuality – US China Links Now in Flux", *Financial Times*, 17 April 2006, at 11.

⁴⁷ The Nobel Prize-winning economist, Robert Mundell, argues inflation is unlikely to occur. The extra yuan issued by the PBOC in exchange for foreign currencies is not spent on consumption items. Rather, Chinese people tend to save the yuan in cash and yuan-denominated assets. As Professor Mundell explains: "If you create money in an equilibrium situation, the additional money makes disequilibrium, and people spend more and that involves more imports, and potentially inflation. But if you print money to fill an excess demand for money, there is no inflation that comes from that." Quoted in Hugo Restall, "Satisfy China's Demand for Money", (June 2007) 170 *Far Eastern Economic Review* No 5, 16, 17 (emphasis added).

Contrary to the impression sometimes conveyed by American officials, China has neither taken a *laissez faire* approach to the Trap, nor does it delight in its ever-greater pile up of dollar-denominated foreign exchange reserves and bilateral trade surpluses with the United States. The reserves are an embarrassment of riches that have to be managed wisely. (To that end, China established a state investment company to allocate about US\$200 billion of its reserves, with a view to enhancing returns and eschewing losses associated with a declining dollar.⁴⁸) While the currency allocations are a secret,⁴⁹ obviously China cannot keep them all in dollars.⁵⁰

⁴⁸ Guo Aibing, n 36 above. Of course, this move raises well-publicised concerns about sovereign wealth funds, not the least of which are transparency and national security.

⁴⁹ See Michael Pettis, n 44 above. Unofficial estimates (as of December 2007) are that dollars account for more than two-thirds of China's total foreign exchange holdings. Quoted in Daniel Dombey, "America Faces a Diplomatic Penalty as the Dollar Dwindles", *Financial Times*, 28 December 2007, at 5.

⁵⁰ Whether the US dollar will remain the single most important reserve currency in the world, be eclipsed entirely by one or more other currencies, or be one of several significant reserve currencies, is a matter of robust debate. On the one hand, after a November 2007 summit of the Organization of Petroleum Exporting Countries (OPEC), Venezuelan President Hugo Chávez triumphantly proclaimed the "empire of the dollar is crashing." Quoted in Dombey, n 49 above. There are a few facts in his favour:

- The IMF reported that (as of 2007) not only does the value of euro notes in circulation exceed that of dollar bills, but also the euro is the main currency in which international debt issuances are denominated. Further, the share of the dollar in known official foreign exchange holdings around the world has dropped from 66.5% to 63.8% (comparing the third quarter of 2007 with the same quarter in 2006). The share of the euro (in the same comparison period) rose from 24.4% to 26.4%. See Ralph Atkins, "Euro Gains Ground on Dollar in Official Foreign Exchange Reserves", *Financial Times*, 12 January 2008, at 1.

- Between February 2002 and December 2007, the dollar has depreciated by 20% against the currencies of leading trading partners. Researchers at the US National Bureau of Economic Research (NBER) estimate that, were that trend to continue, the euro could overtake the dollar as the leading official reserve currency in the world by 2022. See Dombey, n 49 above.

- China is reported to consider a gradual reduction in the dollar weight of its official reserves. See *ibid.* On the other hand, the essentiality of American military forces safeguarding oil supplies from the Middle East no doubt impelled the Kingdom of Saudi Arabia to lead the rejection, at a November 2007 summit of the Organization of Petroleum Exporting Countries (OPEC), of a proposal by Iran and Venezuela – namely, to price oil in a basket of currencies, rather than just dollars. Further, Nobel Prize-winning economist Robert Mundell argues "the dollar era is going to last a long time ... perhaps another hundred years." Quoted in Restall, n 47 above. One externality of the American pressure on China to revalue is a diminution in the political attractiveness of using the dollar as a benchmark of value for a local currency. America's use of its currency to suit its own national security purposes – against Libya, Iran, and North Korea, for example, through asset freeze orders – is well known. Less commonly remembered is the empire America succeeded did the same thing, with the United States playing a China-like role. The United Kingdom used sterling to boost its status, and in the 1956 Suez Crisis, the United States pushed Britain to withdraw its troops from Egypt partly by threatening a run on the pound. See Dombey, n 49 above.

Accordingly, China's July 2005 revaluation included a shift from a dollar peg to basket of currencies. Malaysia immediately followed suit, abandoning its longstanding dollar peg and switching to a basket. See Richard McGregor et al, n 35 above. Put simply, the stronger the American pressure to adjust currency values against the dollar, the greater the political vulnerability of a foreign government to that pressure, and the greater the incentive to get off a dollar standard. If America seeks to retain the pre-eminence of the dollar, then a nuanced approach to alleged misalignments is worth considering.

For the time being, at least, China asserts the US dollar is an important component of its foreign exchange reserves, and its official priorities in reserve management are (1) security, (2)

The surpluses are the epicentre of political and legal tension with the United States.

Accordingly, China has tried to escape the Money Trap through five complementary routes. Between 2002 and 2007, China applied

- (1) administrative controls on growth in specific sectors;
- (2) permitted (in July 2005) a modest appreciation of the yuan, followed by a widening of the band;
- (3) increased on several occasions (seven times between April 2006 and June 2007, with four of the increases in 2007) the minimum reserve requirements that local commercial banks must maintain with the PBOC (thereby contracting the money supply, decreasing the pool of loanable funds of the banks, and raising the cost of capital);
- (4) boosting interest rates on several occasions (six times in 2007, three times between April 2006 and June 2007, with two hikes in the first half of 2007, hence again contracting the money supply, and increasing the cost of credit to the manufacturing sector); and
- (5) sterilisation of the money supply (ie mopping up currency issued after intervening in the foreign exchange market to keep the yuan value stable by offering medium- and long-term bonds).⁵¹

A sixth notable move is the downward adjustment in 2006–2007 by the Chinese government of export tax rebates (including on 2,831 product

liquidity, and (3) investment returns. Private analysts, including Andy Rothman of CLSA Emerging Markets, generally think a major sell-off by China of dollars is unlikely, because it would depress the value of dollar-denominated assets (eg, Treasury securities), and returns from those assets (eg, interest on Treasuries), which China holds. See Amy Tsui, "China Central Bank Official Says Dollar "Important" Component of Chinese Reserves," 24 *International Trade Reporter* (BNA) 1176 (16 August 2007); Richard McGregor, "China Affirms Dollar's Global Reserve Status," *Financial Times*, 13 August 2007, at 4.

⁵¹ See Mure Dickie, "China Raises Rates Again to Curb Inflation," *Financial Times*, 21 November 2007, at 4; Pettis, n 44 above; Guo Aibing, n 36 above. Interestingly, the April 2007 reserve increased by 50 basis points, to 11%, yet the stock market surged 2.17% – surely an indicator the reserve requirement is an ineffectual tool to address the Money Trap. *Ibid.*, at 15. Similarly, the PBOC's sterilisation operations appear ineffectual. As of June 2007, the money supply (measured by M2), grew in China 17.06% (in comparison with June 2006), against a GDP growth rate of 11%. (The PBOC target M2 growth rate, which it set at the start of 2007, was 16%.) The difference between M2 and GDP growth suggests inflation ought to occur. Yet, while rising to 5.6% in July 2007, 6.9% in November 2007, and 7.1% in January 2008, partly because of soaring pork and other food prices, and energy costs, it remains relatively low. See Mure Dickie, "China Says Curbing Inflation is Priority", *Financial Times*, 6 March 2008, at 4; Dickie, n 51 above; Richard McGregor, "China's Inflation Sparks Fears for Economy", *Financial Times*, 14 August 2007, at 3. Therefore, Professor Mundell argues managing the exchange rate is the policy tool of the PBOC with the greatest impact on the Chinese economy, meaning the likelihood of full yuan convertibility is low. See Restall, n 47 above; Guo Aibing, n 36 above. Moreover, a managed pace of yuan appreciation helps China fight import-driven inflation, especially in respect of food, fuel, and raw materials, cuts the build-up of foreign exchange reserves, and lessens the need for sterilisation to control monetary growth. See "Revaluation by Stealth", *The Economist*, 12 January 2008, at 69.

categories in July 2007) – particularly on low-value added ones that are energy intensive and cause pollution.⁵² China adopted the rebates in the late 1990s to encourage exports. Its explicit aims in unwinding them include discouraging exports and export-led growth, slashing the trade surplus, and shifting to domestic consumptive demand as a source of growth. Oddly, though, the adjustment and its goal seem not to be widely acknowledged in the United States.

While the third move prompted some official praise from the United States, China generally gets little political credit for its effort. The fifth policy is not sustainable in the long run, as China well understands. That is because of the real interest rate differential between China and the United States, which has turned sterilisation from a net profitable activity for China (because the interest rate it earned on its dollar-denominated assets exceeded the interest rate it paid on bonds it issued to mop up excess yuan) to a net cost.⁵³ Particularly because of the dramatic interest rate cuts by the Federal Reserve in 2007 and 2008, the interest China collects on its holdings of US Treasury securities is below the interest it is obligated to pay on bonds it issues to sterilise the supply of yuan. Overall, pragmatically, none of the moves has allowed China to escape the Money Trap. Industrial output charges ahead, export surpluses accumulate, foreign exchange reserves pile up, money supply spins upward, lending continues apace, and investment in new projects races on.

Lambasting may be a useful tool in economic discourse among nations, but an intelligent empire understands when empathy is needed. America shows little appreciation for the Money Trap ensnaring the Chinese Dragon. Dramatic revaluation of the yuan, for which officials of the United States Department of the Treasury, and members of Congress, often call, and sometimes with stridency, is not a viable option. That move almost certainly would be a catalyst for a domestic banking crisis. With a sudden, steep drop in foreign exchange deposits from producer-exporters, a liquidity shortage (ie insufficient domestic supply of yuan) could occur.

After all, local banks would have less capital to deposit in the PBOC, receive fewer yuan than before, and their pool of loanable funds would shrink. They might raise interest rates to allocate these funds (and the rates could go up in association with a yuan revaluation) – a classic credit crunch, which would be exacerbated by the fact commercial banks provide the primary source of business finance.⁵⁴ Some existing borrowers might default,

⁵² See Cary Huang and Denise Tsang, “Tax Rebate Cuts Tipped to Slow Export Growth”, *South China Morning Post*, 12 July 2007, at B4.

⁵³ See “Revaluation by Stealth”, *The Economist*, 12 January 2008, at 69.

⁵⁴ See Pettis, n 44 above.

especially ones not creditworthy in the first place, but which received loans when Chinese banks had excess liquidity. One or a few prominent bankruptcies could trigger more, as bad loans and the uneconomic projects they support are exposed. In turn, without a massive injection of capital from the state, banks with weak balance sheets and insufficient capital could collapse.⁵⁵ Rapid capital outflows, ie, capital flight, from China could hasten their demise. Widespread financial panic could ensue. China's export industries could be damaged, unemployment and social unrest could multiply. None of these events is certain, but the mere prospect is monstrous enough to ignore pressure from the United States government on yuan revaluation.⁵⁶

When yelling at the Dragon to revalue, America also shows its official amnesia.⁵⁷ The nearest historical parallel to China's Money Trap is the Japanese experience of the 1980s, when Japan's trade surpluses "create[d] the conditions for more trade surpluses."⁵⁸ Rather than search for lessons from hardly two decades ago, some American officials now whine about an undervalued yen, and even raise the spectre of some sort of trade remedy targeting Japan. In the previous case, coordinated, multilateral action led by the world's key central banks, through the highly publicised December 1985 Plaza Accord and February 1987 Louvre Accord, helped bring about

⁵⁵ A May 2006 study by Fitch Ratings states the total unrealised losses among China's banks exceed their total capital and reserves by one-third, meaning that they are technically insolvent, even without accounting for rapid, low-quality loan growth since the time of the study. The non-performing loans (NPLs) the state has purchased and sold to asset management companies, for subsequent liquidation, has been too slow, and too small in amount (US\$300 billion) to produce its intended effects of strengthening banks and eliminating financial distress costs of debt overhang from borrowers. However, the NPL purchase has dramatically worsened the credit-worthiness of the state, the ultimate guarantor of Chinese banks, as total liabilities of the Chinese government (including contingent ones) possibly exceeding 60% of GDP. See Pettis, n 44 above. See Charlene Chu et al, *China: Taking Stock of Banking System NPLs*, Fitch Ratings, May 2006, available online at <http://www.fitchratings.com/dtp/pdf2-06/bchi3005.pdf>.

⁵⁶ Moreover, there is evidence of the adverse effects in certain manufacturing sectors of a rising yuan on Chinese exporters, with factory closures and relocations, and scaling back or elimination of expansion plans. See eg, Tom Mitchell, "Shoe Industry Under Pressure Amid Rising Costs," *Financial Times*, 26 February 2008, at 10 (reporting on the shoe industry in Dongguan, in southern Guangdong province). An alternative scenario to the one suggested above is rapid appreciation of the yuan could lead to an inflow of "hot money," presumably as investors seek relatively higher returns in yuan-denominated assets. Those capital inflows would exacerbate China's vicious cycle of foreign exchange reserve increases, money supply growth, credit extension, over-investment, over-production, and export surpluses. See Pettis, n 44 above. Accordingly, the only option left, according to Pettis (director of a fund management firm) is "a large one-off jump in the value of the yuan, followed by a peg," which would result in increased domestic consumption that, in turn, would cut capital inflows and the trade surplus. *Ibid.*, at 15.

⁵⁷ Some officials display their curious and selective knowledge of history imperiously. Following the July 2005 revaluation, Senator Lindsey Graham (Republican-South Carolina) said China's July 2005 revaluation "reflected 'a 21st century way of thinking'". Quoted in Edward Alden and Demetri Sevastopulo, "Congress May Tone Down Its Demands," *Financial Times*, 22 July 2005, at 2. The obsession of some American officials with the bilateral trade deficit might be characterised accurately as "mercantilist," which would date their thinking well before the 21st century.

⁵⁸ Pettis, n 44 above.

a stronger yen relative to the dollar at a careful pace, and reduce Japan's yawning surplus. Japan then could not by itself rectify the global imbalances, any more than China can now.

A more distant lesson America could draw is from the experience of the Bank of England in 1947.⁵⁹ The United Kingdom embarked rapidly on full convertibility of the pound sterling. Seeking the security of a diversified savings portfolio, and concerned the government might reinstate capital controls, British savers quickly sold pounds and converted them to assets denominated in foreign currencies. The Bank of England was legally obligated to buy up the pounds in exchange for foreign currencies, and thereby saw its foreign exchange reserves drained. The government had little choice but to reinstate currency controls, or put differently, the prophecy became self-fulfilling. For contemporary China, then, a sudden move to full convertibility could put significant pressure on its foreign exchange reserves. Worse, from the American perspective, that move actually could cause the yuan to depreciate (because of heavy selling of the yuan by Chinese savers).⁶⁰

China's Employment Problem

It should come as no surprise that stability is a prime goal for China's leadership. American officials typically express frustration, even anger, at the slow pace of change in China. Their emotive ejaculations, in which some domestic political constituencies may delight, reflect thoughtlessness in dealing with an ancient culture. For China, the pace and sequencing of reforms are indispensably and inextricably linked to the substance of reform. Indeed, it is part of that substance.⁶¹

Deng Xiaoping wisely characterised China's gradualist approach to reform as crossing a river by feeling the pebbles with one's toes.⁶² Sudden, dramatic changes could exacerbate socioeconomic tensions already

⁵⁹ See Restall, n 47 above.

⁶⁰ This result is forecast by Professor Mundell. See Restall, n 47 above.

⁶¹ See eg, Jiangyu Wang, "Financial Liberalization and Regulation in East Asia: Lessons from Financial Crises and the Chinese Experience of Controlled Liberalization", (2007) 41 *Journal of World Trade* 1, 211–241 (arguing on the basis of the experiences of China and Malaysia that capital account liberalisation should be deferred until an effective domestic regulatory framework and financial infrastructure are in place, and regulatory space should be reserved to allow for independence in financial policy formulation). See also Henry Gao, "China's Participation in the WTO: A Lawyer's Perspective", (2007) 11 *Singapore Year Book of International Law* 1–34 (analysing, *inter alia*, China's extensive commitments in services sectors in connection with its WTO accession, and observing the unique vulnerability to foreign competition of China's financial services sector).

⁶² This oft-quoted phrase (*cheng shi*, meaning a common, short Chinese proverb) was adopted by Deng Xiaoping in a 1979 speech in reference to gradual Chinese economic reforms, and is emblematic of that process. In Mandarin, the phrase is transliterated as *mo zhe shi tou guo he* (essentially, "feel toward rocks head cross river". The phrase – like "open door policy" – is widely known throughout China.

plaguing China. Reports of worker unrest, even violent protests and strikes, sometimes associated with low or unpaid wages, or sub-standard working conditions, seep into the international media.⁶³ With approximately 800 million rural citizens, many of whom are poor, coupled with an effort to industrialise by transferring surplus (ie zero or low marginal productivity) agricultural workers into urban, industrial sectors, China can ill-afford mass uprisings. The Chinese leadership, in particular, surely is aware of its own history from the early twentieth century. Desperate socioeconomic conditions – including mass unemployment, high inflation, and widespread poverty – were fertile ground for the Chinese Communist Party (CCP) to organise, especially among the peasantry, and overthrow the American-backed Nationalist (Kuomintang, or KMT) regime of General Chiang Kai-Shek.⁶⁴

Thus, when the PBOC announced the yuan revaluation in July 2005, it stressed “the exchange rate would be kept ‘basically stable,’” and articulated its intention to “promote basic equilibrium of the balance of payments and safeguard macroeconomic and financial stability.”⁶⁵ To China’s modern leaders, American pressure to revalue the yuan surely conjures up concern about social unrest.⁶⁶ That is true even if American pressure is veiled by soft, ambiguous language, such as in May 2005, when Treasury Secretary John Snow agreed revaluation should be “in a manner and magnitude that is sufficiently reflective of underlying market conditions.” And, that is for good reason.

In a June 2005 study, the Asian Development Bank (ADB) estimated that a 20 per cent revaluation of the yuan would have a devastating effect on China.⁶⁷ It would halve China’s GDP, thus forcing its economy into a hard landing. Put differently, calls for dramatic revaluations are imprudent, because they ignore significant systemic risks to China. An unstable China – mass unemployment and poverty, a collapse in any semblance of the rule

⁶³ See eg, “Chinese Police Arrest 4 Accused of Beating Strikers”, *International Herald Tribune* (Hong Kong edn), 4 July 2007, at 3 (concerning violence against striking migrant workers from Chongqing at the Fuyuan Energy Company in Dongyuan, Gunagdong Province, and commenting on “widespread abuses faced by the country’s 200 million uneducated and grindingly poor migrant workers.”).

⁶⁴ Constant political turmoil and actual or threatened warfare were added fertilisers to that ground. For excellent histories of this period, see eg, Barbara Tuchman, *Stilwell and the American Experience in China: 1911–1945* (MacMillan, 1970); Edgar Snow, *Red Star Over China* (London: Victor Gollancz Ltd., enlarged and revised edn, 1968) (originally published in 1938).

⁶⁵ Richard McGregor et al, n 35 above (emphasis added).

⁶⁶ Quoted in Brett Ferguson, “Yuan Revaluation Gives Minimal Benefit to US, Asian Development Bank Study Says”, *22 International Trade Reporter* (BNA) 943 (9 June 2005).

⁶⁷ See Cyn-Young Park, *Coping with Global Imbalances and Asian Currencies*, (Asian Development Bank, June 2005), available at http://www.adb.org/Documents/EDRC/Policy_Briefs/PBO37.pdf.

of law, and the possibility of internal military action to restore order – surely cannot be in America’s long-term interest.

4. Moderation and the Gluttonous Empire

Moderation, one of the Four Cardinal Virtues, is not the same as abstinence. Rather, as one catechetical source explains:

“The fourth of the cardinal virtues is *temperance*, which disposes us to control our desires and especially to use rightly the things which appeal to our senses. ... Temperance does not eliminate, it *regulates* desire. ... [T]he removal of obstacles consists mainly in the avoidance of circumstances which would excite desires which may not, in conscience, be gratified.”⁶⁸

Moderation requires self-control, and on occasion self-denial. In other words, moderation is the balancing of two opposing extremes and choosing to walk a path that splits the two. While it does not demand a life of asceticism, gluttony is its antithesis.

That America is anything but a moderate nation is an observation made by no less an authority than David Walker, Comptroller General of the United States and Head of the General Accounting Office (GAO). He admonishes America to learn from the downfall of the Roman Republic:

“... [W]e must not take comfort in our nation’s current superpower status and past success. For a lesson in what we should avoid, we must learn from history. In this regard, the Roman republic fell for a number of reasons and three in particular resonate today.

First, there has been a *decline in moral values* and political civility at home. Examples include the devaluation of life, *greater self-centeredness by individuals* and increased partisanship and ideological divides in Congress.

Second, we now have an overextended military around the world. While the U.S. military is unmatched as to its capabilities, it is under stress and stretched very thin.

Last, there is *fiscal irresponsibility by the central government*. Our debt ratios are set to increase dramatically when the baby boomers retire. [In particular, during fiscal years 2001-2006, total liabilities

⁶⁸ Leo J. Triese, n 2 above (emphasis in original).

and unfunded commitments for pension and health care assistance for the elderly (Social Security and Medicare, respectively) grew from \$20 to \$60 trillion, and short-term federal deficits are massive.]

...

As George Washington once said, we should avoid 'ungenerously throwing upon posterity the burdens that we ourselves ought to bear'.⁶⁹

In the context of international trade, what would be the hallmark of a moderately behaved trade empire?

Following from both catechesis and the Comptroller, the answer is the demonstrated ability of the trade empire to exercise self-restraint. First, that empire is reasonable in the demands it puts on its trading partners, including the demand to change trade measures that impinge on the empire. Rather than press every point to its full advantage, the empire appreciates the repeat-iteration game it plays with lesser powers. Second, self-regulation occurs in its internal, as well as external, behaviour. It is not profligate in its own acts, policies, or practices. How does America measure up to the virtue of moderation in responding to the challenge of yuan undervaluation? Do the American trade deficits and saving rate indicate a passing grade on moderation hardly is merited?

America's Trade Deficits

Concededly, China's trade surplus numbers are staggering. From 1994 to 2006, America's bilateral trade deficit with China increased by 570 per cent (when adjusted for inflation), from US\$30 to US\$171 billion (in 1994 dollars).⁷⁰ China's trade surplus with the world increased eight-fold between 2004 and 2007.⁷¹ Expressed as a percentage of its GDP, China's overall trade surplus was about eight per cent (for the first half of 2007), and rose from four to 11 per cent from 2004 to year-end 2007.⁷² Even the eight per cent

⁶⁹ David Walker, "America Risks the Fate of the Roman Republic", *Financial Times*, 22 August 2007, at 9 (emphasis added). See also Jeremy Grant, "Learn from Fall of Ancient Rome, Official Warns US", *Financial Times*, 14 August 2007, at 2. The full discussion by Walker, which is both fascinating and chilling, is "Transforming Government to Meet the Demands of the 21st Century," Presentation by the Honorable David M. Walker, Comptroller General of the United States to The Federal Midwest Human Resources Council and the Chicago Federal Executive Board, Chicago, Illinois, 7 August 2007, General Accounting Office Document Number GAO-07-1188CG, available at <http://www.gao.gov>.

⁷⁰ See "Trade in Goods (Imports, Exports, and Trade Balance) with China", US Census Bureau, available at <http://www.census.gov/foreign-trade/balance/c5700.html> and CPI Inflation Calculator, Bureau of Labor and Statistics, <http://data.bls.gov/cgi-bin/cpicalc.pl>. (The figures mentioned are rounded to the nearest billion.)

⁷¹ See Richard McGregor, "China's Exports Boost Trade Surplus", *Financial Times*, 16–17 February 2008, at 2.

⁷² See "Revaluation by Stealth", *The Economist*, 12 January 2008, at 69.

figure is larger than the trade surplus-to-total output ratio of any other large economy in recent history (including Japan).⁷³

Trade deficits – both bilateral and overall current account figures – change. They expand, contract, and even become surpluses. America's trade deficit with China (as of March 2006) was US\$202 billion.⁷⁴ As of that month, America's overall current account deficit was approximately US\$850 billion a year. Yet, the figures for China changed, and the deficit began to level out as the dollar depreciated against the currencies of many major trading partners, and as the American economy slowed.⁷⁵ In 2007, America's overall trade deficit dropped for the first time in five years, by 6.2 per cent from 2006, to US\$711.6 billion, though the bilateral deficit with China rose 10.2 per cent to US\$256.3 billion.⁷⁶

Let the simple fact that a trade deficit is not a static statistic – that it can and does change over time – be put aside. A threshold question about the yuan-dollar exchange rate is why the bilateral trade deficit (whatever it may be now, and whatever the trend line might look like) with China should matter at all. The most obvious answer is a persistent bilateral trade deficit with China contributes mightily to the hollowing out of the American manufacturing sector. One economist with the pro-labour Economic Policy Institute (EPI) in Washington, DC, Robert Scott, estimates the trade deficit with China caused a loss of 1.46 million American industrial jobs between 1989 and 2003.⁷⁷ Yet, that easy answer is unpersuasive.

Especially by think tanks that might harbour political agendas, causation can be confused with correlation, and specific causal factors can be over-emphasised relative to others. Whether or not American job losses are caused by the deficit, or correlated with it amidst other variables (such as China's WTO entry, effective 11 December 2001) is the topic of earnest debate. No less robust a debate exists over attribution of blame to other possible causal variables, such as the relocation of American multinational corporations (MNCs) to low-cost jurisdictions (including, but not limited to, China), and the trend toward sourcing inputs from those jurisdictions.

One irony in the American position is its impatience with the self-correcting potential of global markets. In the first six months of 2007,

⁷³ See Joseph Kahn, "Trade Surplus for China Hits Record \$26.9 Billion", *International Herald Tribune* (Hong Kong edn), 11 July 2007, at 1 (discussing a study by Hong Liang, an economist for Goldman Sachs in Hong Kong).

⁷⁴ Edward Alden, Richard McGregor and Demetri Sevastopulo, "Mistrust and Mutuality – US China Links Now in Flux", *Financial Times*, p 11, 17 April 2006.

⁷⁵ Krishna Guha, "An Equilibrium That Cannot Be Sustained", *Financial Times*, p 3, 13 September 2006.

⁷⁶ See "Record Exports Cut US Trade Deficit", *Financial Times*, 15 February 2008, at 2.

⁷⁷ See Robert E. Scott, "US – China Trade, 1989-2003: Impact on Jobs and Industries, Nationally and State-by-State", EPI Working Paper No 270 (8 January 2005).

American economic growth was an anaemic annualised rate of about two per cent, not only less than its potential rate, but also considerably slower than in other parts of the world (including China and East Asia).⁷⁸ Along with the trade deficit itself, weak relative economic growth puts downward pressure on the dollar. In time, these underlying economic fundamentals ought to lead to dollar depreciation, as the so-called “J-curve” relationship between a trade deficit and exchange rate suggest. That is exactly what happened in respect of the dollar-pound rate, which hit a 26-year nadir in July 2007, and dollar-euro rate, which also hit a historic low that month.⁷⁹ In brief, assuming no outright manipulation or fixing of the yuan–dollar rate, market forces make depreciation nearly inescapable. What follows that, of course, is a slowing in the growth of the trade deficit, as dollar-invoiced exports rise because they are cheaper than before, and eventually even an elimination of that deficit.⁸⁰ To be sure, the J-curve process is likely to take a protracted period of time. Depreciation cannot lead to an immediate cut in a trade deficit, simply because as a legal matter import-export contracts are negotiated and signed for future delivery before the exchange rate change (ie there is merchandise in the pipeline).

Nevertheless, on the assumptions (1) China’s undervalued currency boosts its trade deficit and erodes America’s industrial base, and (2) this causal direction is irreversible without intervention, a *leitmotif* in American trade policy is to demand revaluation to correct the deficit and thereby safeguard blue-collar jobs. Even assuming *arguendo* the assumptions on which it rests are correct, the American position exalts without justification one political constituency in the United States above all others. When China revalued in July 2005, a controversial icon of American business, Wal-Mart, along with other major retailers, were dubbed “clear losers”.⁸¹ They source inputs based on cost, and the cheapest costs often are in China.

⁷⁸ See “Dollar Slide Backed by Economic Trends”, *Financial Times*, 14 July 2007, at 6.

⁷⁹ See Larry Swisher, “US Trade Gap Narrowed to \$711.6 Billion in 2007, as Deficit with China Hit New High”, 25 *International Trade Reporter* (BNA) 264–265 (21 February 2008) (reporting that “[a]mong major trading partners, the deficit last year [2007] narrowed with Europe, Canada, and Japan, while expanding with China, OPEC, and Mexico”).

⁸⁰ See Jeremy W. Peters, “US Trade Imbalance Widens, But the Pace Slows”, *International Herald Tribune* (Hong Kong edn), 14–15 July 2007, at 13. Not surprisingly, at the end of 2007, the United States Manufacturers Alliance / MAPI (a non-profit research organisation) forecast American exports in 2008 would rise by 8.7%, following a 7.7% increase in 2007, because of continued depreciation of the dollar against foreign currencies, despite slower global economic demand. See “US Export Growth Forecast to Pick Up in 2008, as Weaker Dollar Offsets Slowdown”, 25 *International Trade Reporter* (BNA) 191 (7 February 2008). Similarly, there are intimations “the period of huge expansion of the controversial [trade surplus of China] might be drawing to a close.” Richard McGregor and Krishna Guha, “China’s Trade Surplus Growth Set to Slow”, *Financial Times*, 12–13 January 2008, at 2.

⁸¹ “Competitors Shrug Off Change As Too Small To Make A Big Difference”, *Financial Times*, 22 July 2005, at 1.

Other losers were American companies, such as Motorola, which use China as a manufacturing and export platform. The larger the proportion of inputs such firms source from within China, and the greater the value they add to products in China, the more adverse the effect of revaluation on them.

Statistics plainly bear out the fact that the American policy cuts in different directions:

“...[C]urrent xenophobic attitudes toward China are unsubstantiated by the facts.

As with Japan, the US trade deficit with China is largely illusory.

...

... [T]he trade deficit with China is largely the result of China opening up its markets – something the US has long desired. In 1986, the per cent share of China’s exports attributable to foreign-invested enterprises stood at 1.9%; that figure rose to 57% by 2004.

...

... [M]ore than 50% of the goods China exports are from non-Chinese owned factories or companies. Consistent with this, the U.S. trade deficit with China has increased concomitant with decreases in the trade deficit with other U.S. trading partners such as Singapore, Japan, and Taiwan who [sic] have reduced exports from their own country [sic] and relocated production facilities to China.”⁸²

Put succinctly, globalisation means (*inter alia*) that the costs and benefits of currency adjustments depend on the geographic location and business model of a company, not on the location of its headquarters. Overall tallies for a complex, diverse economy amount to simplistic generalisations.

In turn, a persuasive case about the meaning of a bilateral current account imbalance must be made to support a strenuous campaign against China to revalue. That case has yet to be made. For two reasons, the vacuum is dangerous. First, with no cogent case from its trading partner, China is free to focus on its national interests. That cuts against an official American policy goal of making China a responsible stakeholder in the global trading system. Second, the absence of a focused, technical argument as to why China should be concerned about the imbalance invites the worst fears in China. With the long, dark shadow of Spheres of Influence at the end of the Qing Dynasty (1842, the date of the Treaty of Nanking, to 1937, when the Japanese launched a full-scale invasion of China) still cast over the

⁸² Van Jackson, “China Unlearns US Trade Lessons”, 171 *Far Eastern Economic Review* No 1, 29, 31 (January/February 2008).

minds of Chinese citizens, what is at stake from their view?⁸³ Is it, perhaps, an imperialistic effort to damage China's economy, because the country is a strategic threat to the United States? Incautious – dare it be said, immoderate – demands from the American side can be contagious, exacerbating a bilateral climate of mistrust. Notably, over half of Americans think China is an adversary, and just 28 per cent view it as an ally.⁸⁴

Putting aside the economic debate about whether bilateral trade deficits matter, it is nearly incontestable that China's state-controlled exchange rate has little causal effect on its bilateral trade surplus with the United States, and even less so on the overall American current account deficit. As the *Financial Times* summarises:

“Many economists say the focus on the currency is misleading, arguing that the trade surplus [of China] reflects an *explosion in demand in developed countries*, and a shift by manufacturers to China as a final point of assembly for their goods.”⁸⁵

Similarly, the Conference Board – an American business research organisation – stresses:

“Although an undervalued currency contributes to China's trade surplus, it is *not* the primary cause of it and has *very little to do* with the bilateral United States – China trade deficit.”⁸⁶

The real culprit is the savings–investment imbalance. This conclusion is widespread among market participants, too.

Consider the research of Andy Rothman, based in Shanghai as the chief China strategist for the securities giant CLSA Emerging Markets. He explains:

“The move [to impose a 27.5 per cent tariff on Chinese imports into the United States] is foolish because *the Renminbi–US dollar peg does not contribute significantly to the US current account deficit*, and counter-productive because heightened foreign pressure will only make it more

⁸³ The Qing Dynasty itself stood, of course, from 1644–1911, yet the Spheres continued through the Republic of China era (following 1911, even into the chaotic war period of 1937–1949, and ultimately until the 1949 Communist takeover of the mainland).

⁸⁴ See Andrew Ward and Edward Luce, “Democratic Rivals United in Tough Line on Beijing”, *Financial Times*, 16 August 2007, at 3.

⁸⁵ Richard McGregor, “China's Exports Boost Trade Surplus”, *Financial Times*, 16–17 February 2008, at 2 (emphasis added).

⁸⁶ “Quoted in Revaluation by Stealth”, *The Economist*, 12 January 2008, at 69.

difficult for Beijing to adopt a more flexible exchange rate mechanism.”⁸⁷

Rothman further points out that

“[t]he value of the yuan is *not* the most important factor in the Chinese trade picture. US exports to China have increased by 188 per cent since 2001, a much faster rate of growth than the United States has had with any other major trading partner, despite what some economists argue is the yuan’s artificially low purchasing power.

This is a very long-term structural problem that the Chinese are as eager as anyone else to fix.... But we have to recognize that it will take more time.”⁸⁸

This conclusion is shared by prominent regional organizations, such as the Asian Development Bank (ADB). In a June 2005 study, the ADB concluded a 10 per cent revaluation of the yuan would improve the current account deficit by only about five per cent (a US\$3.6 billion reduction in the then US\$666 billion American current account deficit).⁸⁹ A 20 per cent revaluation of the yuan would improve the deficit by just over 10 per cent (a US\$7.9 billion cut to the US\$666 billion deficit).

The reason for this conclusion is obvious. America trades with the world, not just China. Chinese products amount at most to 13 per cent of total imports into the United States.⁹⁰ The American trade deficit with China (as of April 2006) is only a quarter of its overall deficit. Conversely, China’s current account surplus is only a sixth of the surpluses of oil exporters and advanced economies.⁹¹

⁸⁷ Quoted in Richard McGregor, “China Currency Trades Briefly Outside Set Band”, *Financial Times*, 30 April–1 May 2007, at 2. Market observers, too, agree revaluation has little effect on the bilateral imbalance. For example, speaking of the July 2005 revaluation, Dr Gary Hufbauer of the Institute for International Economics in Washington, DC, concluded: “It doesn’t do anything on the numbers...”. Quoted in Edward Alden and Demetri Sevastopulo, “Congress May Tone Down Its Demands”, *Financial Times*, 22 July 2005, at 2.

⁸⁸ Joseph Kahn, “Trade Surplus for China Hits Record \$26.9 Billion”, *International Herald Tribune* (Hong Kong edn), 11 July 2007, at 1 (discussing and quoting Rothman).

⁸⁹ See Cyn-Young Park, “Coping with Global Imbalances and Asian Currencies”, (Asian Development Bank, June 2005), available at http://www.adb.org/Documents/EDRC/Policy_Briefs/PBO37.pdf; Brett Ferguson, “Yuan Revaluation Gives Minimal Benefit to U.S., Asian Development Bank Study Says”, *22 International Trade Reporter* (BNA) 943 (9 June 2005).

⁹⁰ Martin Wolf, “Why Washington and Beijing Need Strong Global Institutions”, *Financial Times* 19 April 2006, at 15. In 2006, the United States imported a total of US\$2,204,225 (in millions of dollars) in goods and services. See “US Total Import Trade in Goods and Services”, United States Census Bureau, available online at <http://www.census.gov/foreign-trade/statistics/historical/gand-simp.pdf>. Of this total, only US\$287,774.4 (in millions of dollars) came from China. See “Trade in Goods (Imports, Exports and Trade Balance) with China”, United States Census Bureau, available online at <http://www.census.gov/foreign-trade/balance/c5700.html#2006>. Thus, goods and services imported from China into the United States amounted to roughly 7.66% of total imports.

⁹¹ Martin Wolf, “Why Washington and Beijing Need Strong Global Institutions”, *Financial Times* 19

Thus, even senior American officials agree with the private sector and regional development banks, as well they should on this topic, that a revalued currency would have little effect on the bilateral or overall deficit. For example, four United States Senators who co-sponsor protectionist legislation against China write in an article supporting their bill:

“... Undervalued currencies make the offending country’s exports unfairly cheap, keep U.S. exports to that country unduly expensive, and contribute to harmful trade deficits, perilous current account surpluses, inflation, and other unsustainable trends. China’s *renminbi* is just the most recent example. Tomorrow it could be another economy’s currency, with even more devastating effects.

...

There is no one answer to America’s international economic concerns. Reducing the U.S. trade deficit will require boosting national savings, promoting U.S. exports, and investing in responsible health care and energy policies.”⁹²

Oddly, the legislation they co-sponsored contained no measures to boost national savings, promote American exports, or invest in responsible health care and energy policies. Rather, the bill targeted countries with misaligned currencies, and all but mentioned China by name. Here, then, is a paradox: some of the same senior American government officials, or their close colleagues, who declaim China’s unfairly aligned currency readily admit realignment would do monstrously little to correct trade imbalances.

One way to explain the paradox is to ascribe the incongruity to immoderation. The officials may not lack for intelligence. But, they make inconsistent utterances they could avoid if only they employed their acumen in a disciplined manner. Failing to appreciate the faults of their own country, yet zealous to spotlight and magnify where China errs, is self-indulgent. It even may be characterized as a species of intellectual gluttony. Indubitably, the effect is to exacerbate trade friction – inflaming tensions as manifest in the number of disputes and rhetoric surrounding them.

Might the remarks of senior American officials be chalked up to a deliberate strategy of pressure on China to revalue, regardless of the quantitative impact on the bilateral trade deficit? Possibly, though that strategy would seem to lack restraint. Surely China would interpret that pressure as imperialistic bullying, not pressure grounded on America’s calculated self-interest.

April 2006, at 15.

⁹² Max Baucus, Chuck Grassley, Chuck Schumer and Lindsey Graham, “We Must Act When Currencies Become Misaligned”, *Financial Times*, 6 July 2007, at 9.

Moreover, that strategy would be immoderate in view of Congressional efforts (discussed below in Section 6) to authorise remedies against Chinese imports. Why pressure China to revalue, and simultaneously push legislation to punish Chinese imports? That is, if revaluation is economically insignificant, then why not drop it from the dialogue with China, and thereby narrow the range of disputed issues, to outright remedial measures?

Saving and Consumption

Chinese households save, culturally abhorring debt. Steeped in a material culture, many American households spend themselves into deep debt. Here is a stereotype with more than a kernel of truth. From an economic perspective, underlying the bilateral trade imbalance with China (and the red numbers in the overall current account deficit) is the imbalance in American consumption versus saving. Indeed, the point is an elementary macroeconomic one.⁹³

To illustrate briefly this linkage in an open economy (ie one engaged in the international exchange of goods, services, and investments), recall a few basic macroeconomic equations:

Equation 1: Components of GDP

$$\text{GDP} = C + I^T + (G - T) + (X - M)$$

where:

- GDP = Gross Domestic Product
- C = Consumption (gross private consumption expenditures)
- I^T = Total national investment (total private investment in domestic capital), typically called "Investment"
- G = Government expenditures (goods and services, but not transfer payments)
- T = Taxes
- $(G - T)$ = Net government expenditures
- X = Exports (sales of goods and services to foreigners)
- M = Imports (purchases of goods and services from foreigners)

⁹³ The discussion below of the savings/investment relationship in an open economy draws heavily on the classic textbook, Paul A. Samuelson and William D. Nordhaus, *Economics* (McGraw-Hill Irwin, 18th edn, 2005) Chs 21 and 30. The large imbalances the United States has built up over several years, specifically its lack of savings and associated current account and fiscal deficits, have attracted criticism from (*inter alia*) senior European policy makers, including the EU Commissioner for Monetary Affairs, who calls them "the main reason" for turmoil in global equity markets. Quoted in Tony Barber, "Europe Blames US Policies for Turmoil in World Markets", *Financial Times*, 23 January 2008, at 2.

$(X - M) =$ Net Exports, which is approximately the same as Net Foreign Investment⁹⁴

Equation 2: Saving – Investment Identity

$$S = I^T$$

where:

S = Total national saving by the private sector (households and businesses) and the government (through budget surpluses).

This identity means total national saving must equal total national investment. This identity holds true because (1) S is the part of national income that is not consumed, (2) I^T is the part of national output that is not consumed, and (3) national output and national income are equal, reflecting two ways to measure GDP, namely, the flow-of-product approach or the earnings (cost) approach.

Equation 3: Components of Saving

$$S = S^P + S^G$$

This equation explains S consists of the sum of private saving, S^P , and government saving, S^G ,

⁹⁴ Why are Net Exports treated as the same as Net Foreign Investment? See Samuelson and Nordhaus, n 93 above, at 438, 628. While Professors Samuelson and Nordhaus assert the equivalence, an intuitive explanation is as follows. (An explanation based on Balance of Payments (BOP) accounting is beyond the scope of this article.) Suppose $X - M > 0$, ie, $X > M$, which means Americans sell more goods and services to foreigners than they buy from foreigners. To pay for their purchases of American goods and services, foreigners pay money to the sellers in the United States. Consequently, there is a net inflow into the United States of funds. That inflow goes into the coffers of the American producers, exporters, and service suppliers that sold goods and services to foreigners. These American recipients can invest their earnings, for example in capital (property, plant, equipment, and software) in their own businesses. Whether they do, in fact, invest their earnings (as opposed to paying them out as dividends on stock, paying down debt, or consuming them in some way) depends on several factors, especially the real interest rate (the higher the rate, the more attractive an investment vehicle would be) and various investment alternatives (which compete for the funds of investors). Still, the net inflow of money generated by positive Net Exports is roughly the same as Net Foreign Investment. Conversely, suppose $X - M < 0$, ie, $M < X$. Americans buy more goods and services from foreigners than they sell to them. They pay for these goods with money, but there is an excess of (1) payments to foreigners for goods and services purchased over (2) revenues earned from foreigners from selling them goods and services. That is, there is a negative net inflow of foreign investment (commonly called an outflow). The foreign producers, exporters, and service suppliers earning money from selling to Americans obviously can invest their earnings. Again, whether and how they do so depends on a variety of factors, not the least of which is the real interest rate and alternative investment possibilities.

where:

$$\begin{aligned} S^P &= \text{private saving (by households and businesses)} \\ S^G &= \text{government saving, which is a fiscal surplus, that is, an excess of T} \\ &\quad \text{over G} \\ &= T - G \end{aligned}$$

Because S^G is the same as $T - G$, the equation can be rewritten:

$$S = S^P + (T - G)$$

This equation states total national saving is the sum of private saving by households and businesses, plus government saving obtained through fiscal surpluses.

Equation 4: Components of Investment

$$I^T = I + (X - M)$$

In an open economy (ie, an economy open to international trade), investment funds may come from domestic sources, I , or from Net Exports (Net Foreign Investment), $X - M$.⁹⁵ This equation states that total national investment, I^T , is the sum of investment in domestic capital, I , plus Net Exports, $X - M$.

Equation 5: The Saving – Investment Relationship in an Open Economy

$$S + (T - G) = I + (X - M)$$

This equation is derived directly from the Saving – Investment Identity (Equation #2), $S = I^T$. It is the same Identity, but the individual components of S (Equation #3) are substituted for “ S ”, and particular components of I^T (Equation #4) are substituted for “ I^T .” In turn, this equation (with the substitutions) can be manipulated simply to spotlight Net Exports:

$$(X - M) = S + (T - G) - I$$

⁹⁵ Similarly, in an open economy, such as the United States, world financial markets are not only a source of investment funds to that economy, but also an outlet for domestic saving from that economy. For instance, Americans can and do obtain investment funds from abroad, and invest a modest portion of their own saving overseas.

This final equation states Net Exports equal the sum of private saving and government saving, less domestic investment.

Put equivalently, the final equation says Net Exports equal the difference between domestic saving (private and public) and domestic investment. Intuitively, if there is a positive difference between domestic saving and investment, then that difference must arise from an excess of (1) earnings from exports of goods and services over (2) payments for imports of goods and services. Conversely, if domestic saving is less than investment, then the reason must be greater spending on foreign goods and services than the amount earned from exported goods and services.

This final equation also indicates the effect of domestic saving on Net Exports.⁹⁶ If domestic savings ($S + (T - G)$) decrease, and there is no change in I or any other factor (the “*ceteris paribus*” assumption), then the result must be a dampening effect on Net Exports. Intuitively, the private sector and government are consuming the goods and services of others from abroad (M), rather than saving funds ($S + (T - G)$), which can be channelled into production and exporting. These fundamental macroeconomic principles may be applied straightforwardly to the trade relationship between the United States and China.

The facts on relative savings rates are simple and powerful. The saving rate (S in the above equations) in the United States has dropped dramatically over the past two decades.⁹⁷ In the third quarter of 2007, the personal savings rate in America was a woeful 0.6 per cent of disposable income.⁹⁸ However, even that figure is misleading. The Bureau of Economic Analysis at the Department of Commerce estimates the personal savings rate of current income hovered near zero, or was even negative. That is because some personal expenditures are financed by borrowing, selling assets or other investments, or dipping into savings from previous periods.⁹⁹ Indeed, the ratio of household debt to disposable income is above 130 per cent.¹⁰⁰ Worse

⁹⁶ See Samuelson and Nordhaus, n 93 above, Table 30-3 at 632.

⁹⁷ Economists fault the declining saving rate to several factors, including, but not limited to: (1) social security benefits, which reduce the incentive for households to save, and partly shift the burden to save from the taxpayer to the government; (2) increased easy credit, particularly the proliferation of credit cards, which encourages people to borrow (even at high interest rates); and (3) a rapid growth in wealth, such as the boom in asset prices (especially stocks and real estate) in the 1990s, which causes the “wealth effect” that stimulates consumption and lowers personal saving. See Samuelson and Nordhaus, *Economics*, n 93 above, at 456–457.

⁹⁸ That is, individuals only save 0.6% of their total income less taxes. See “GDP and the Economy – Final Results for the Third Quarter of 2007”, United States Department of Commerce, Bureau of Economic Analysis, January 2008, available online at http://www.bea.gov/scb/pdf/2008/01%20January/0108_gdpecon.pdf.

⁹⁹ “News Release – Gross Domestic Product: Third Quarter 2007 (Advance)”, United States Department of Commerce, Bureau of Economic Analysis, 31 October 2007, available online at <http://www.bea.gov/newsreleases/national/gdp/2007/pdf/gdp307a.pdf>.

¹⁰⁰ See “America’s Economy”, *Economist*, 17 November 2007, at 80–82.

yet, the government ($T - G$ in the above equations) is hardly a role model on savings for its citizens. The United States has run a government budget deficit every year since 2002.¹⁰¹ Conversely, China boasts a personal savings rate higher than the international average.¹⁰² In 2006, for example, China's personal savings rate was over 25 per cent of disposable income.¹⁰³ Further, the Chinese government cut its budget deficit by nearly half from 2005 to 2006, totalling just less than one per cent of total GDP.¹⁰⁴

These facts suggest an underlying problem, from the American side (a problem that is not popular to admit), is gluttony. In the long run, a change in the relative prices of domestic and foreign goods and services, which occurs in a flexible exchange rate regime through exchange rate appreciation or depreciation, helps bring about an adjustment in trade accounts (Net Exports, or $X - M$ in the above equations).¹⁰⁵ That basic point is not in question or doubt. But, it is pertinent to inquire, introspectively, into all key factors that contribute to a large, persistent negative trade account position.¹⁰⁶ Attacking China for an undervalued currency when the savings rate of American households is so low, even negative, and when the government, too, is in deficit, is a convenient – and popular – way to shift blame. In sum, America's propensity to spend – facilitated by credit cards available to all, zero-percent financing on consumer durables, and other emoluments – fuels purchases of Chinese merchandise.

¹⁰¹ See "Newly Available NIPA Tables", United States Department of Commerce, Bureau of Economic Analysis, October 2007, available online at http://www.bea.gov/scb/pdf/2007/10%20October/1007new_nipa.pdf.

¹⁰² See Louis Kuijs, "How Will China's Saving-Investment Balance Evolve?", WPS3958 (June 2006), available online at http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/06/28/000016406_20060628102757/Rendered/PDF/wps3958.pdf.

¹⁰³ See "A Worker's Manifesto for China", *The Economist*, 11 October 2007, available online at http://www.economist.com/finance/displaystory.cfm?story_id=9944703.

¹⁰⁴ See "China at a Glance", World Bank, 28 September 2007, available online at http://devdata.worldbank.org/AAG/chn_aag.pdf.

¹⁰⁵ See Samuelson and Nordhaus, n 93 above, at 630, 632, 640.

¹⁰⁶ See, eg, Martin Wolf, "Why Washington and Beijing Need Strong Global Institutions", *Financial Times*, 19 April 2006, at 15 (suggesting the need for an honest, objective economic solution).

5. Courage and the Irresolute Empire¹⁰⁷

Sir Winston S. Churchill thought courage the indispensable virtue, because without it, no other kind of virtuous behaviour is possible.¹⁰⁸ But, what is “courage”? The Kennedy-esque formula, well-suited for a political context, is grace under pressure.¹⁰⁹ One catechetical source provides a complimentary, yet more considered, explanation:

“*Fortitude*, the third cardinal virtue, disposes us to do what is good in spite of every difficulty. The perfection of fortitude is exemplified in the martyrs, who have accepted death rather than sin. Few of us are likely to be called upon for such an extreme degree of fortitude. But the virtue will never be able to operate, even in the small demands made upon our courage, unless we chop away at the barriers. Such barriers as an exaggerated desire to conform, to belong, to be “one of the crowd.” Such barriers as an unreasonable fear of public opinion ...; the fear of being criticised or belittled; or, worst of all, ridiculed.”¹¹⁰

¹⁰⁷ It is important not to ascribe support for, or opposition to, any one bill to the Administration of President George W. Bush. As a general matter, and abstracting from disagreements that may exist within or between Executive branch agencies, that Administration preferred (at least through the July 2005 yuan revaluation) to eschew formal trade sanctions against China. As one analyst put it: “The traditional pattern is for the administration to be the free-trade anchor and Congress to tug it towards protectionism.” Andrew Balls and Alan Beattie, “US Treasury Welcomes Currency Reform”, *Financial Times*, 22 July 2005, at 2 (emphasis added) (quoting Tom Gallagher, a Washington, DC consultant). Of course, Congress hardly is unanimous on any one bill. Accordingly, as elsewhere in this article, the discussion of legislative initiatives simply treats the United States government as a whole, without differentiating its parts and their stance on particular bills.

Similarly, it is important not to characterise the entire American government as indifferent to multilateral trade rules. In the Congressional debate about the Currency Exchange Rate Oversight Reform Act of 2007 (discussed above in section 6), some Senators sought “the strongest possible [legislative] language to press the Chinese to move faster on currency reform, while devising a bill that will not be seen by the WTO and international community as retreating from the United States’ international trade obligations.” Amy Tsui, “Senate Debate on Currency Bills, China yuan Affected by Doubts About WTO Compliance”, 24 *International Trade Reporter* (BNA) 1260–1262 (6 September 2007). In respect of using CVDs as a remedy against currency undervaluation, some legislators, such as Senator Jim Bunning (Republican–Kentucky), at least asserted consistency between a remedy proposed to the Senate and WTO rules. See *ibid.* at 1260. Others, such as Senators Debbie Stabenow (Democrat–Michigan) and Charles Schumer (Democrat–New York), supported proposals (including on CVDs), even if the remedy contemplated would be inconsistent with those rules. (Senator Stabenow took the pragmatic position the AD and CVD provisions of any legislation should be severable, so if one is declared non-compliant with WTO rules, the other remedy will remain in force.) Still other Senators, like Finance Committee Chairman Max Baucus (Democrat–Montana) inclined toward eschewing a CVD bill that might not pass muster under WTO rules. See *ibid.*

¹⁰⁸ See Sir Winston Churchill, *Great Contemporaries* 137 (London: The Reprint Society, 1941) (1990 edn).

¹⁰⁹ See John F. Kennedy, *Profiles in Courage* 17 (Black Dog & Levanthal Publishers, 1955).

¹¹⁰ Leo J. Triese, n 2 above at 115–116 (emphasis in original).

Put simply, courage is a steadfast commitment to do good in the face of adversity. Courage requires a display (sometimes quiet, sometimes grand) of trust in one's judgment of good, and in the mechanisms that ought to be used to promote good. Conversely, succumbing to internal insecurity, external threat, or even inescapable suffering, and thereby losing grip of the good, is its antithesis.

In turn, a hallmark of a courageous trade empire is sticking to policies long promoted and preached to other (particularly developing) countries. For the United States, those policies, of course, champion open markets, trade liberalisation, and adjudication and enforcement of the international rule of law through multilateral institutions like the WTO. Courage demands policy consistency, even if those policies, when implemented in the United States or another country, have deleterious repercussions for one or more American constituencies. Those negative effects could include losing one or more individual legal battles.

The short-term loss of a case by the United States in an international legal forum (such as the WTO) would be outweighed by the courage America showed, namely, to test the scope, meaning, and application of legal rules. Shrinking from or declining to mount a legal challenge could well suggest doubt in those rules, plus a lack of trust in multilaterally-agreed upon procedures. Accordingly, does America's reluctance to litigate against China on currency manipulation merit a low mark on courage?

Rejecting Section 301 Petitions and a Test of GATT Article XV:4

Article XV:4 is an untested, even obscure, provision of the General Agreement on Tariffs and Trade (GATT).¹¹¹ This provision, and the accompanying Interpretative Note, state:

"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 [IMF].

Ad Article XV

Paragraph 4

The word "frustrate" is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable

¹¹¹ Article XV:4, like the rest of GATT, is folded into the WTO agreements as an Annex 1A accord to the Agreement Establishing the World Trade Organization (WTO Agreement).

departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import license the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.¹¹²

The purposes of GATT are laid out in its preamble, namely:

“Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods,

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce
...”¹¹³

Might Article XV:4 provide the United States with a credible legal claim against China’s undervalued yuan-dollar peg, or a tightly managed but undervalued yuan?

Specifically, applying this Article to the facts at hand, does China “frustrate” the “intent” of GATT by its “exchange action”? Does it “frustrate” the “intent” of IMF Articles by its “trade action”? To answer these questions, several intermediate points need consideration. First, is a yuan-dollar peg (or tightly managed regime) “exchange action,” “trade action,” or both? Second, should a distinction be drawn as to the nature of that peg (or regime) before versus after the July 2005 revaluation? Third, what does “frustrate” mean in international trade law? Is the definition the same as in well-established Anglo-American contract law doctrine on frustration, and

¹¹² Emphasis added. GATT is reproduced in many sources, including Raj Bhala, *Documents Supplement for International Trade Law: Interdisciplinary Theory and Practice* (LexisNexis, 3rd edn, 2008).

¹¹³ *Ibid.*

as embodied in international commercial law? Fourth, what is the “intent” of GATT and the IMF Articles?

Logically, then, if a currency peg (or tightly managed rate) were “exchange action,” but not “trade action,” then the United States would need to show the peg (or regime) “frustrates” the “intent” of GATT. If a peg were “trade action,” then it would need to show the peg “frustrates” the “intent” of the IMF Articles. The best scenario for the American side would be that a peg counts as both “exchange” and “trade” action. Optimism is appropriate in respect of the yuan-dollar peg. Surely that peg operates directly “exchange action,” because the Chinese government tightly manages the yuan-dollar rate? Surely the peg operates nearly as directly as “trade action,” because that rate sets the price for Chinese exports and American imports, thereby impacts balances of trade. The Americans could intone that if the yuan-dollar regime is neither “exchange” nor “trade” action, then Article XV:4 has no meaningful scope, because what – pray tell – would qualify? In this best of scenarios, the United States could show “frustration” of the intent of GATT, the IMF Articles, or both.

The most conservative legal position is to respond negatively, ie to take the approach the United States probably lacks a credible legal claim. Because GATT Article XV:4 is untested, it is nearly impossible to predict how an American claim based on it would fare in front of a WTO panel or the Appellate Body. Why not, then, simply back off any litigation? The answer, simply put, is this position is too weak to befit an imperial trade power.

Is it not the duty of a courageous trade empire to assume the risks of legal uncertainty, litigate key issues, and thereby enhance the rule of law – indeed, all the more so if that empire preaches the rule of law to the world?¹¹⁴ If lawyers who are naysayers dominate, then the accretion of thousands of their pessimistic judgments slowly kills the imperial trade power. Such powers, if they are not paper tigers, ought to be courageous enough to probe the unknown with cogent argumentation. Assuming the test is not a foolhardy roll of the dice, the imperial power will make its position clear through written and oral advocacy, advance the international rule of law by charting new waters, and itself following dispute settlement procedures. Win or lose, in the process it will gain the respect of other trading nations, including its adversary in the case.

Unfortunately, the United States scrambled to the weak position. Suppose, however, the United States elected to bring an Article XV:4 case against China. What specific legal barriers would it have to surmount to

¹¹⁴ The controversial argument that a strong empire is one governed by the rule of law is hardly novel, but rather underpins classic liberal international legal scholarship. The realist rebuttal, of course, is that rules are for the weak, ie, an empire does not them, because of its powers of coercion.

enhance its chances of success? Let the easier case be assumed, and set aside concerns about defining “frustration” and “intent.” That is, assume if the peg (or, again, firmly controlled rate) is an “exchange action,” then it frustrates the intent of GATT, as that intent is manifest in the Preamble – namely, to liberalise trade. What about the harder case, in which the peg is a “trade action”? Might there be a credible argument the United States could make that China’s currency regime violates the rules of the IMF?

That argument would arise under Article IV:1(iii) of the IMF Charter. On 15 August 1971, President Richard Nixon closed the “gold window,” ending the convertibility of US dollars into gold. That led to the demise of the gold standard, and the collapse of the par value system the IMF had administered since its founding under the Bretton Woods Agreement of 1944. To reflect this paradigmatic shift in the foreign exchange world, members of the IMF approved the Second Amendment to the IMF Charter in 1978.¹¹⁵ The Second Amendment permits an IMF member country to choose any exchange rate arrangement – that is, any method of valuing its currency against other currencies. However, that freedom comes with responsibility, as new Article IV disciplines the choices countries make.

One discipline is especially pertinent to the contemporary Chinese yuan issue. Section 1(iii) of the new Article IV requires each IMF member country to “avoid manipulating exchange rates ... to gain an unfair competitive advantage over other members.” A currency value that is beneath the price the market would place on that currency, based on real and perceived economic and political strengths in the country issuing that currency would be an instance of undervaluation. Deliberately maintaining an undervalued currency certainly could be viewed as exchange rate “manipulation” under Section 1(iii). The advantage gained from such “manipulation” could be – indeed, assuredly would be – import suppression and export propulsion.

Suppose the manipulation is done with the intent, or has the effect of, gaining that advantage? The benefit accrued, in other words, is based neither on Adam Smith’s principle of absolute advantage, nor on David Ricardo’s principle of comparative advantage.¹¹⁶ Is there not a credible argument that the issuing country behaves inconsistently with Section 1(iii)? The answer is “yes.” Whether it is a winning case is uncertain. The facts are incomplete. The arguments need developing. The key point for present purposes is the United States has not ventured to probe the factual

¹¹⁵ The First Amendment to the *Charter* occurred in 1969. It authorised the IMF to issue Special Drawing Rights (SDRs), which are treated in Asif H. Qureshi and Andreas R. Ziegler, *International Economic Law* Ch 8 (Sweet & Maxwell, 2nd edn, 2007).

¹¹⁶ For a discussion of these principles, see, eg, Raj Bhala, *International Trade Law: Interdisciplinary Theory and Legal Practice* (LexisNexis, 3rd edn, 2008), Ch 7.

predicate or formulate arguments that might make the case. It has not, in brief, dared to put China to the legal test of Article IV:1(iii).¹¹⁷

Notably, history could be on the American side in such a case. Repelling imports and spurring exports is precisely the kind of unfair competitive advantage sought during the Inter-War years (1919 to 1939), during which countries engaged in competitive devaluations to boost domestic price levels and favour their trade balances. Through exchange rate machinations, coupled with outright protectionism, countries pursued disreputable beggar-thy-neighbour policies to continue use of production capacity, export unemployment, and minimise social unrest. The individual frenzies of particular nations, writ large, are noted by some scholars to have exacerbated the Great Depression.¹¹⁸ Concern about competitive devaluation of currencies was a major factor leading to the establishment of the IMF.¹¹⁹

More specifically, three goals were important in respect of the establishment of the IMF and the post-Second World War fixed exchange rate regime. They might be synthesised as “reality,” “stability,” and “convertibility” of exchange rates. “Reality” meant the value of the currency of a country should reflect the value the market would place on it based on the long-term economic strength, political climate, and other relevant factors. “Stability” meant currency values should be stable, because dramatic volatility – whether in practice or the risk thereof – raises the transaction costs of, and potentially impedes, the cross-border trade of goods or services. That

¹¹⁷ Here again, admittedly, a reasonable characterisation is that America’s choice is one of courageous forbearance, not irresolute weakness. That is, not taking China to court, as it were, under the IMF Charter is a sign that America is willing to give China time to implement difficult currency reforms. The problem with that characterisation is its incongruity with the rhetoric of many Congressional and Executive branch officials, and policy observers, the existence of aggressive legislative proposals aimed at China, all of which cast doubt on whether patient engagement is America’s underlying strategy.

¹¹⁸ See, eg, Alonzo L. Hamby, *For the Survival of Democracy: Franklin Roosevelt and the World Crisis of the 1930s* (New York: Free Press, 2004) Chs 1–3 (summarising the history of the Great Depression, including the 1930 Hawley-Smoot Tariff Act and the division of the world into currency and trading blocs); Charles P. Kindleberger, *The World in Depression: 1929–1939* (New York: Basic Books, 1986) Chs 4–11 (discussing, *inter alia*, the slide into the abyss, the 1933 World Economic Conference, and currency and gold standard issues); Kenneth W. Dam, *The Rules of the Game: Reform and Evolution in the International Monetary System* (Chicago: University of Chicago Press, 1982) Ch 3 (concerning competitive devaluations and depreciations, especially by the United States and United Kingdom, and their purposes and effects).

¹¹⁹ See John W. Head, *The Future of the Global Economic Organisations: An Evaluation of Criticisms Leveled at the IMF, the Multilateral Development Banks, and the WTO* (Ardsley, N.Y.: Transnational Publishers, 2005) Ch 3 (detailing and critically appraising the operations and effectiveness of the IMF); Harold James, *International Monetary Cooperation Since Bretton Woods* (New York: Oxford University Press, 1996) Chs 1–6 (chronicling the birth and early history of the IMF); Kenneth W. Dam, *The Rules of the Game: Reform and Evolution in the International Monetary System* (Chicago: University of Chicago Press, 1982) Chs 4–6 (concerning the Bretton Woods Agreement, IMF, and collapse of the Bretton Woods System); Robert Lekachman, *The Age of Keynes* (New York: Random House, 1966) pp 183–186 (discussing the arguments put forth by Lord Keynes, including stability and convertibility, in 1943–1944 about the benefits to Great Britain of an IMF).

is, if the foreign exchange rate risk is sufficiently great, then commercial transactors face a choice. Either they must allocate that risk, sometimes by means of hedging instruments (eg currency forwards, options, or swaps), or they must abandon (or at least postpone) the underlying transaction. Either choice is costly. “Convertibility” ensures that one currency can be translated into another without hassle or delay as needed by transacting parties. If an exporter needs a currency different from that of its home country to pay an invoice for imported merchandise, then it can obtain the currency of payment by converting from its home currency. In any event, the architecture of the par value and gold standard system following the Second World War was designed, in part, to achieve these three goals. Following its 1971 collapse, the bulwark against such behaviour is new Article IV, Section 1(iii).

Reality, stability, and convertibility can of course operate independently of one another. For instance, in respect of the yuan-dollar rate, commercial parties generally may be pleased at a set rate of 7.28 yuan per dollar. But, depending on their transactional position, they may be upset at the lack of reality. Chinese importers and American exporters chafe at yuan undervaluation. The mirror image problem could occur if China moves to a floating exchange rate regime. The yuan-dollar rate would be more volatile than before, but would reflect better market variables. The overall point, nevertheless, is that the goals for the IMF and the global currency exchange system it oversaw, and still to some degree oversees, remain important today. Invoking these goals in legal argumentation against China’s undervaluation would only buttress the American case.

Were the United States to take the resolute action of challenging China under the IMF Charter, two corollary legal issues might arise worth remarking. First, the venue might be the IMF Board. The United States would need to seek a ruling from the IMF board. That might raise political difficulties. Different IMF members, with different voting shares, would be cast in the role of judges. Then, the IMF decision could affect subsequent proceedings in the WTO. After all, it must be stressed that trade action that runs contrary to the intent of the IMF articles falls within the ambit of GATT Article XV:4.

The general litigation scenario, then, would be an IMF decision followed by WTO action. In this regard, a fascinating legal question concerns the relationship between the IMF and WTO, and in particular, the status and effect of IMF rules in the WTO. To what extent would a WTO panel, or the Appellate Body, use IMF rules, including any IMF decision applying those rules to China’s currency valuation, as a basis for a ruling on a GATT

Article XV:4 claim!¹²⁰ The best estimate is a WTO adjudicator would be unlikely to use those rules, or a decision, as anything more than support for its decision. That is, it would base its decision on provisions in a covered text, ie, a WTO accord, and IMF requirements would at most provide a supporting rationale, akin to an argument in expert testimony or *amicus curiae* brief. Three rationales support this forecast.

First, the DSU requires WTO panels and the Appellate Body to take decisions only on the basis of covered agreements.¹²¹ Second, WTO precedent suggests panels and the Appellate Body take this requirement seriously. Notably, in the *Argentina – Textiles and Footwear* case, the Appellate Body ruled there is no obligation under WTO rules to comply with IMF disciplines. The Appellate Body rejected Argentina's argument, that following IMF strictures justified its disputed trade measure. Third, principles of public international law would not justify use by a WTO adjudicator of an IMF rule or decision as the legal ground (as opposed to guidance) for a holding.

The third rationale requires amplification. As a general proposition, there are three recognised ways in which IMF rules, including an IMF decision, could be applicable in a WTO proceeding. First, the rules are an accepted source of public international law, under Article 38(1) of the Statute of the International Court of Justice.¹²² In particular, one possibility would be the

¹²⁰ This question presumes the IMF would render a decision against China in respect of the yuan valuation. That presumption is arguable. On the one hand, in so far as the IMF is more politicised than a WTO panel of the Appellate Body, ie, relatively more susceptible to political influences, the IMF may find it difficult indeed to take such a decision. On the other hand, to the extent the IMF feels the influence of the United States and its allies on the issue, the IMF may be inclined to take that decision. The position of the EU could prove critical, and the EU might well side with China. Indeed, there is evidence to suggest the EU fears a yuan revaluation, because it might contribute to upward pressure on the euro relative to the dollar, making EU exports to the United States less competitive. Notably, in contrast to American officials, EU Trade Commissioner Peter Mandelson, not only admits the role of economic fundamentals in contributing to the EU's bilateral trade deficit with China, but also tends not to fixate on the value of the yuan, and instead focus on structural impediments and political roadblocks to market access: "Europe's trade deficit with China is growing. Now I accept that part of this deficit may be the natural result of market forces. But we also know that our export potential is being hampered by barriers in the Chinese market, that an important part of the current trade balance is artificial." "Mandelson Blames Chinese Barriers for Low EU Exports", *South China Morning Post*, 12 July 2007, at B6 (emphasis added). See also Tony Barber, "EU Joins China in Currency Moves Pact", *Financial Times*, 28 November 2007, at 3 (reporting the euro has appreciated against both the yuan and dollar, hence (1) European exports to China are less competitive than before the appreciation of the euro against the yuan, and (2) American exports to China are relatively cheaper than European exports to China, because of the depreciation of the dollar against the euro).

¹²¹ One scholar might urge that the WTO should account for non-WTO rules. See Joost Pauwelyn, "The Transformation of World Trade", (2005) 104 *Michigan Law Review* 1, 62. But, it is unlikely the WTO Legal Affairs Division, or the Appellate Division, would agree that panels or the Appellate Body should stray beyond the text of covered agreements to find a foundation for decision-making.

¹²² See Statute of the International Court of Justice, Art 38(1)(d), 26 June 1945, 59 Stat 1055. Arguably, a distinction should be made between IMF rules and decisions. An IMF decision could fall under Article 38(1)(d) of the ICJ statute, which covers judicial decisions and scholarly teachings. Yet, even that source is evidence of what international law is, not the law itself.

rules are accepted as part of customary international law. Article 38(1)(b), refers to “international custom, as evidence of a general practice accepted as law,” and thus would require the IMF rules to be both general practice and accepted as law. Another possibility would be that the rules amount to a general principle of law. Article 38(1)(c) concerns “the general principles of law recognized by civilized nations.” Accordingly, the rules would have to embody postulates that are independent of custom (and treaties), and these postulates are fundamental and universally recognised, concern the administration of justice, or are needed to fill gaps in international law.¹²³

Neither of these alternatives seems correct, at least not perfectly so in a technical sense. Rather, the rules of the IMF, under its Articles of Agreement, are treaty obligations (implicating Article 38(1)(a) of the ICJ Statute).¹²⁴ As such, however, a new difficulty arises: membership in the IMF and WTO is not co-extensive. Certain customs territories, notably Chinese Taipei (Taiwan) and Hong Kong, are WTO but not IMF members. Thus, claiming IMF rules are applicable to WTO members as a treaty obligation is problematical.¹²⁵ In contrast, as customary international law or general principles, the rules are applicable regardless of membership in the IMF versus the WTO.

Second, the IMF rules are explicitly incorporated by reference into the text of a WTO agreement. Certainly, there are references to the IMF in WTO accords.¹²⁶ However, none of those references addresses the dispute at

¹²³ See Stephen C. McCaffrey, *Understanding International Law* (Newark, N.J.: LexisNexis, 2006) §3.03[B] at 44–45 (concerning customary international law), §3.03[C] 56–68 (concerning general principles of national law).

¹²⁴ Treaty obligations are given legal effect by Article 26 of the Vienna Convention on the Law of Treaties, which states “every treaty in force is binding upon the parties to it and must be performed by them in good faith.” (Vienna Convention on the Law of Treaties, Art 26, 23 May 1969, 1155 UNTS 331). Further, Art 31(1) requires that treaties “be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” Vienna Convention on the Law of Treaties, Art 31(1), 23 May 1969, 1155 UNTS 331.

¹²⁵ An interesting analogy arises in respect of bilateral investment treaties (BITs). Suppose BIT #1 is between Countries A and B, and BIT #2 is between Countries B and C. An arbitral case arises under BIT #2 between Countries B and C. Would an arbitrator apply BIT #1 in this case to Countries B and C? The general response to this Maffezini-style investment problem, is no (as B, but not C, is a party to BIT #1). The exception is where a most-favoured nation (MFN) type clause exists and is applicable, which directs the arbitrator to do so.

¹²⁶ Specifically, the WTO refers to the IMF in: Art III of the Agreement Establishing the World Trade Organization; the summary of the Decision on Achieving Greater in Global Economic Policy-Making; the Declaration on the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking; and the Declaration on the Relationship of the World Trade Organization with the International Monetary Fund. All references appear in the Uruguay Round Final Act. See Uruguay Final Round Act, 15 December 1993, Annex 1B, GATT Doc No MTN/FA, 33 *International Legal Materials* 1130 (1994). Significantly, the WTO and IMF signed a cooperation agreement in December 1996. See World Trade Organization, “The WTO and the International Monetary Fund”, available online at http://www.wto.org/english/thewto_e/coher_e/wto_imf_e.htm. For a thorough analysis of the legal relationship between the WTO and the IMF, see Deborah E. Siegel, “Legal Aspects of the IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements”, 96 *American Journal of International Law* 561 (2002).

hand, namely, whether an officially-sanctioned undervalued yuan frustrates the purpose of GATT Article XV:4. It might be added that under public international law principles, as between two or more potentially applicable rules (eg WTO and IMF obligations), the governing rule is decided on the basis of which rule is later in time, and which rule is the most specific to the dispute at hand. The later-in-time principle favours application of WTO, not IMF, rules, as the relevant dates are 1995 (specifically, 1 January 1995, if the date the WTO agreements entered into force is selected, or at the earliest 1 January 1948, if the date GATT entered into force is used) and 1944, respectively. A plausible argument might be made the specificity principle (*lex specialis derogate generali*) favours application of WTO rules, because they focus on foreign exchange as it relates to trade. A rebuttal, however, might be constructed. Article IV:1(iii) might be viewed as the more specific as the two rules, evidenced by the fact that GATT Article XV:4 incorporate it as a part of a broader framework.

Third, under an agreement between the IMF and WTO, WTO adjudicators are required to apply IMF rules or decisions. There is an IMF–WTO agreement on exchange matters that requires the WTO to take account of IMF decisions on such matters. But, how the agreement does not explain how the WTO is to do so, and in particular does not mandate an adjudicator use those decisions as a, or the, basis for decision making. Thus, a conservative forecast would be – again – a panel or the Appellate Body accord to an IMF rule or decision the status and effect of expert testimony or an *amicus* brief. Indeed, Article 31(3)(c) of the Vienna Convention on the Law of Treaties might provide a WTO adjudicator with reinforcement for this approach. That provision authorises examination of the context of an agreement when seeking to interpret a disputed provision, assuming neither the text nor the object and purpose of the agreement resolves the dispute. The IMF–WTO agreement could be construed as part of the context for a dispute over GATT Article XV:4.

The “bottom line” implication for an American claim under GATT Article XV:4 is significant. If a WTO panel or Appellate Body would be unlikely to use an IMF rule or decision as a firm foundation for a decision, then why should the United States fear that rule, or fear seeking that decision? The “best case” scenario is the United States obtains a favourable IMF ruling, adverse to China, which it then uses as evidence to support its WTO claim. The “worst case” scenarios for the United States are (1) China persuades a WTO panel or the Appellate Body to ignore or de-emphasize an IMF rule or decision against it, or (2) the United States persuades the WTO tribunal to do the same, in the event the rule or decision favours China. In brief, the legal risk to a courageous imperial trade power seems reasonable.

In weighing this risk, the United States might well consider additional legal bases for its claim that China's undervalued currency violates its WTO obligations. Notably, one of many terms of China's accession to the WTO concerns its national treatment commitments. China agreed to grant foreign firms and individuals national treatment in respect of both trade and foreign exchange rules. Might the United States fashion a claim that currency manipulation treats Chinese firms and individuals more favourably than foreigners? Might there be a related MFN claim, insofar as the effect is on the dollar and Americans? Courage would have the United States press these legal points.

Rejecting Section 301 Petitions and a Test of WTO Export Subsidy Rules

Succinctly put, the United States Trade Representative (USTR) has refrained from using Section 301. That is not for lack of opportunity. China Currency Coalition (CCC) is an *ad hoc* group of agricultural, industrial, service, and labour organisations. The CCC counts among its allies 42 members of Congress, not the least of which are Speaker of the House Nancy Pelosi (Democrat-California), Senator Barack Obama (Democrat-Illinois), House Ways and Means Committee Charles B. Rangel (Democrat-New York), and Trade Subcommittee Chairman Sander M. Levin (Democrat-Michigan).¹²⁷

On 9 September 2004, the CCC filed with the USTR a petition under Section 301 of the United States Trade Act of 1974, as amended.¹²⁸ This statute empowers the President to take unilateral remedial action against foreign acts, policies, or practices that are unjustifiable or discriminatory against American commerce.¹²⁹ The petitioners alleged China's undervalued yuan-dollar peg is a *de facto* prohibited subsidy within the meaning of the SCM Agreement. The allegation clearly contemplated the dispute is within the ambit of a WTO accord, hence under the terms of section 301, if it accepted the petition, the USTR would be obligated to utilise the dispute settlement provisions of the WTO, ie, to bring a case under the Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding, or DSU).

In other words, the petitions essentially asked the USTR to bring a DSU case under the SCM Agreement. The petitioners identified the facts

¹²⁷ See Our Members, China Currency Coalition, available at <http://chinacurrencycoalition.org/members.html>.

¹²⁸ The petition is posted at Section 301 Petition, China Currency Coalition, <http://chinacurrencycoalition.org/petition.html>.

¹²⁹ The statute is codified at 19 USC §2411. The statute itself is terribly worded, an offering to the demons of ambiguity and circularity. For a discussion of it, see Raj Bhala and Kevin Kennedy, *World Trade Law* Ch 10 (Lexis Law Publishing, 1998, plus 1999 Supplement).

supporting a claim under the SCM Agreement: the Chinese government sponsored a financial contribution to its exporters by mandating they convert hard currency earnings, namely, US dollars, into yuan at a price that understates the true value of the yuan, and conversely overstates the true value of the dollar.

For instance, an exporter obtains 7.5 yuan for each dollar it converts, rather than a (hypothesised) market rate of 6 yuan. The controlled rate represents a 1.5 yuan per dollar benefit. There are two further benefits. First, Chinese government currency action makes it unnecessary for exporters to price exchange rate risk into their transactions. They need not spend money or time on foreign currency hedges (forward, futures, options, or swaps) to mitigate the risk of yuan appreciation. Second, export revenues are greater than they otherwise would be, because of the reduced price of Chinese merchandise to American consumers resulting from the over-valued dollar. As for the specificity test, which must be satisfied for a “subsidy” to exist under Article 1 of the SCM Agreement, the CCC argued yuan undervaluation confers a benefit specifically to actual or anticipated exportation. To be sure, China does not declare export promotion to be the purpose of its currency regime – any more than the United States said so in respect of the foreign sales corporation tax benefit. Yet, the effect of the regime is to assist exporters in particular.

The CCC counsel, David Hartquist, further urged, in respect of possible legislative responses to the currency issue, “the US government needs to take its chances that a US law addressing currency might not comply with the WTO.”¹³⁰ Perhaps covered by the CCC arguments, the USTR declined to bring the action. Courage is a virtue that entails willingness to take a risk, even lose a case, in a just cause. In eschewing a legal test of the definition of “subsidy” and Red Light subsidy rules in Article 3 of the SCM Agreement, the USTR reaction was parlous in at least two respects.

First, the USTR did not address the substance of the CCC argument. Ambassador Susan Schwab asserted:

“We do not believe that this Section 301 petition is likely to be the most productive way to secure Chinese movement towards currency flexibility.”¹³¹

¹³⁰ Amy Tsui, “Senate Debate on Currency Bills, China yuan Affected by Doubts About WTO Compliance”, (2007) 24 *International Trade Reporter* (BNA) 1260–1262. (The quotation is that of Ms Tsui, characterising Mr Hartquist’s observations.)

¹³¹ Quoted in Amy Tsui, *ibid.*

That declaration would be comforting if the Ambassador kindly had laid out a route that was supremely efficacious. Not doing so, the USTR did little other than confirm suspicions that lawyers for the American trade empire were bereft of responsive strategies.

Second, the USTR has had years to muster up courage to bring a currency case against China. Since China acceded to the WTO effective 11 December 2001, there have been approximately three formal Section 301 petitions on the currency issue. The USTR has rejected each one of them. The latest such rejection was on 13 June 2007, when the USTR turned back the CCC section 301. Its refusal to accept any section 301 petition cannot be explained by an utter lack of legal merit to the petitions. The sum and substance of the section 301 petitions is an entreaty to the USTR to probe the potential application of the SCM Agreement to merchandise from countries with misaligned currencies. Smart, experienced lawyers outside of the American government already have opined on different sides of these questions.¹³² Their views, even when tentative or contingent, evince the CCC case is anything but laughable. Their doubts could be incorporated into a brief in a WTO action, and thereby strengthen the brief – if only the USTR would file one.

Fear, of course, is emotive, not rational. Ought responses to yuan undervaluation be influenced by fear? If fear of losing a WTO case accounts (even in part) for official reluctance to accept a section 301 petition, then that emotion needs to be confronted with the reality of previous cases litigated. The USTR has persisted in defending DSU challenges, rather than settling them, on matters where chances of success were dim indeed. Zeroing is a prime example. Why the USTR would argue with messianic zeal in such instances, yet cower at a currency subsidy case catalysed by a section 301 petition containing *bona fide*, if uncertain, arguments, is odd. Might the pattern be one of imprudence in identifying litigation priorities?

¹³² *Ibid.*, discussing the April 2007 CCC survey of 10 groups or individuals involved in international trade law on whether exchange rate misalignment would satisfy WTO criteria for a countervailable subsidy).

6. Justice and the Unfair Empire?

General Criteria: Justice as Fairness

To ask what is “justice” is to raise an age-old philosophical and theological question far beyond the present scope. To narrow and simplify the inquiry, how is “justice” explained for catechetical purposes? One answer is:

“The second cardinal virtue is *justice*, which perfects our will (as prudence perfects our intelligence) and safeguards the rights of our fellow man: his right to life and freedom, to the sanctity of the home, to his good name and honor, and to his material possessions. An obstacle to justice ... is prejudice. ... Another obstacle might be a natural stinginess, closefistedness....”¹³³

To be sure, there are different kinds of justice – principally commutative, distributive, legal, and social.¹³⁴ However, a common feature of all types is fairness, both substantive and procedural, embodied in the relevant rules. Again at the risk of over-simplification, among the antitheses of justice, or at least the breeding grounds for injustice, are self-interested opportunism, hypocrisy, ambiguity, and secrecy.

In turn, a general criterion that a trade empire manages itself in a just manner is fairness. To what extent are its trade measures – acts, policies, and practices – fair? That consideration is neither myopic nor self-referential. Rather, the analysis focuses on long-term needs and interests of, and consequences for, the global community. It is not too much of an overstatement to say fairness accounts for the common good, or appropriately balances competing interests. Fairness connotes that unilateralism, self-interest, and subjectivity are not exalted over consensus, collective benefit, and objectivity.

Accordingly, a justly managed trade empire, when contemplating legislative changes, asks whether those changes embody standards for judgment that are clear and widely accepted. The empire queries whether the judges themselves are consistent in the standards they elaborate and apply. If not, do they articulate reasonable grounds for departure? If these questions are put to the Congressional approaches to yuan undervaluation, then how does the American trade empire measure up to the virtue of justice? Should a failing grade on justice be assigned?

In respect of the four legislative responses of Congress, the answers depend critically on two factors: the details of the approaches, and specific

¹³³ Leo J. Triese, n 2 above (emphasis in original).

¹³⁴ See Raj Bhala, *Dictionary of International Trade Law* (LexisNexis, 2008) (entry for “social justice”).

hallmarks of fairness. Simply put, what does a bill propose to do, and what particular indicia of fairness are relevant to analysing the proposals?

A Bevy of Bills, But Four Basic Legislative Responses

Without doubt, several American politicians have raced against one another to attack China by introducing legislation to punish that country for its undervalued currency. The current 110th Congress, plus the previous three Congresses – 107th, 108th, and 109th – span the years 2000 to the present, and encompass the full period of China's WTO membership (which took effect on 11 December 2001).¹³⁵ During these four Congresses, there have been 55 bills (in the House and Senate) to deal with yuan undervaluation and its effect on Sino–American trade.¹³⁶ The figure of 55 excludes 11 proposed resolutions that express the sense of Congress, but do not call for statutory change. For four reasons, the figure of 55 needs to be viewed with perspective.

First, there is some double-counting within a particular Congress, because a bill with identical or similar language is introduced into both chambers, either simultaneously or sequentially. Second, there is some double-counting across Congresses, because an identical or similar bill is recycled from an earlier to a later Congress. That is the case, for instance, with respect to the 27.5 per cent tariff proposal. Third, both within a particular Congress and across time, competing legislation may be introduced in the same chamber. (That has occurred, for instance, as regards criteria for applying CVDs to non-market economies (NMEs). Fourth, and perhaps most importantly, no bill (or resolution) yet has passed both chambers and

¹³⁵ China's WTO membership is an appropriate cut-off date, not only in order to delimit the scope of research to a manageable proportion. Once China acceded to the WTO, the United States had an international legal obligation (and opportunity to do so) to respond to yuan undervaluation within the GATT–WTO legal regime, and a forum for doing so, or to explain why that multilateral regime is inapplicable. The two countries thus began a new era of bilateral economic relations on a technically level playing field. Before China became a WTO Member, much Congressional attention was focused on whether to remove China from the annual Jackson–Vanik Amendment review and grant it permanent most-favoured nation (MFN) treatment. Ever since then, there have been calls to withdraw China's normal trade relations (NTR) status. Conversely, yuan undervaluation has been a long-standing concern of Congress. Some pre-2000 bills on MFN treatment addressed, or explicitly were motivated by, currency manipulation. See, eg, S 1034, 103rd Congress, 1st Session (introduced by Senator D. Riegle (Democrat–Michigan), 26 May 1993).

¹³⁶ The 55 bills and 11 resolutions are available on line at The Library of Congress, <http://thomas.loc.gov>, and are culled from a search revealing (depending on the precise search terms used) between approximately 916 and 1,950 proposals on China. Obviously, the culling led to exclusion of bills focusing on the “Three Ts” (Taiwan, Tibet, or Tiananmen) (eg, from the 110th Congress, H Res 73, concerning resumption of diplomatic relations with Taiwan, and from the 108th Congress, S Res 365, concerning Tibetan prisoners), American requests for diplomatic support on dealing with North Korea (eg from the 107th Congress, H Res 213, concerning North Korean refugees) or Sudan (eg from the 110th Congress, S Res 203, concerning Darfur), and the 2008 Summer Olympics in Beijing (eg from the 110th Congress, H Res 608, calling for a boycott), which were bereft of trade remedy content. A Table on file with the author surveys the 55 bills and 11 resolutions.

become law. There is no way of telling whether a politician introduces a particular bill with the intent of pressuring, or even scaring (if that is possible) China into revaluing its yuan, knowing full well *a priori* the bill never will be enacted. Good faith must be presumed of every legislator to see his or her proposal become law.

With these caveats in mind, the 55 legislative proposals since 2000 may be grouped into four categories. The categories are based on their central thrust, that is, the remedy – or penalty – they seek:

- Redefining currency manipulation.
- Imposing a tariff surcharge.
- Applying CVDs to NMEs.
- Adjusting dumping margin calculation in AD investigations.

The bills are quintessential examples of the relevant category. Each bill is from the current Congress, with references where appropriate to earlier Congresses. The critical thematic point is the bills are evidence America risks acting unfairly in running its trade empire.¹³⁷

Failing to define appropriate currency alignment

One hallmark of a just trade empire is its ability to articulate clear, transparent, universal standards for differentiating appropriate from unlawful commercial conduct among nations. Critical statutory definitions cannot be simply “what is good for us,” as that would equate justice with self-interest and subjectivity. Rather, if a definition is to be accepted widely as legitimate, then it requires some claim to fairness. No piece of American legislation on the alignment of China’s currency relative to the dollar has met this challenge.

Defining currency misalignment is a tricky business. In the context of the yuan valuation dispute, the key term is “manipulation,” or its euphemism, “misalignment.” Officially, the United States never has branded China a currency “manipulator.” While it has done so unofficially on many occasions, it has shied away from a formal declaration that could be made by the Department of the Treasury in a semi-annual report mandated by the Omnibus Trade and Competitiveness Act of 1988 (1988 Act). One explanation senior Treasury Department officials give for not dubbing China a

¹³⁷ A relevant practical question is whether a trade remedies approach, embodied in these bills, is superior to a GATT Art XV:4 action. That is, concerns about justice as fairness aside, what strategy is best for the United States to pursue to realise its goal of dramatic yuan revaluation? Is it, for example, better to bring a claim of exchange action under Art XV:4, or to treat the dollar–yuan exchange rate as a dumping problem? A short answer is it depends on the strength of the theory of a proposed trade remedies bill and its technical legal details.

currency manipulator is China's motive. China does manipulate its currency, but not to gain an unfair trade advantage. Rather, its motive is to cope with a parlous banking system, potentially large inflows and outflows of currencies, and rural unrest.¹³⁸ The explanation, while a bit circular (in that manipulation really is not manipulation unless the intent is bad), of course, is plausible. However, the official reluctance may well arise out of an inability to reach – or worse, fear of reaching – a legal conclusion that China satisfies the *mens rea* requirement of the statute, namely, it intentionally manipulates the yuan.¹³⁹

It might be urged that many, even most, countries manipulate their currency. That claim, which ultimately must be based on empirical analysis, would depend on the definition of “manipulation.” Does “manipulation” require persistent intervention by a central bank through buying and selling of currencies over a sustained period? Are policy changes short of foreign exchange transactions, such as interest rate and reserve requirement alterations, sufficient to constitute “manipulation”? Does intervention require direct action by a central bank, or would indirect influence government officials exercise – through phone calls to private foreign exchange dealers, and interviews with the press – count? How long must intervention occur – would episodic action over a few months be enough, or is a longer period of investigation (POI), akin to an AD or CVD case be needed? In sum, a credible definition of “manipulation” requires careful thought as to the means, manner, and duration of intervention. And, of course, whether the offence is a strict liability one, making intent irrelevant, or whether some degree of intent is needed, must be decided. In the latter instance, a non-exclusive list of evidentiary bases for a finding of intent is helpful, if not indispensable.

The leading effort on defining currency “manipulation” is the Currency Reform and Financial Markets Access Act of 2007 (section 1677), co-sponsored by Senators Christopher Dodd (Democrat–Connecticut) and Richard Shelby (Republican–Alabama).¹⁴⁰ They are, respectively, the Chairman

¹³⁸ See Amy Tsui, “China Controls Currency to Avert Instability in Financial Markets, Treasury Official Says”, 24 *International Trade Reporter* (BNA) 1148–1149 (9 August 2007) (reporting on testimony before the House Ways and Means Trade Subcommittee by Mark Sobel, Deputy Assistant Secretary of the Treasury).

¹³⁹ Thus, in its 13 June 2007 and 19 December 2007 Reports, the Treasury Department trotted out its familiar conclusion: yes, the yuan is undervalued; no, China is not manipulating the yuan to gain a trade advantage. See Rossella Brevetti, “Treasury Dept Report Again Declines to Label China a Currency Manipulator”, 25 *International Trade Reporter* (BNA) 18–19 (3 January 2008); Amy Tsui, “Senate Debate on Currency Bills, China yuan Affected by Doubts About WTO Compliance”, 24 *International Trade Reporter* (BNA) 1260–1262 (6 September 2007).

¹⁴⁰ The 109th Congress generated two bills of note concerning the definition of “currency manipulation.” The Fair Currency Practices Act of 2005, HR 2208, and its exact Senate counterpart, S 984, defined (in s 2(b)(3)) the term as “protracted large-scale intervention in one direction in the

and Raking Minority Member of the Senate Banking, Housing, and Urban Affairs Committee. On a 17 to four vote, the Banking Committee passed section 1677 in August 2007.¹⁴¹

The effort appears to elide the issue of how best to gauge currency misalignment. Specifically, the Dodd–Shelby bill (section 1677):

- Amends the Exchange Rates and International Economic Coordination Act of 1988.¹⁴²
- Encourages (in section 101(5)-(6) of the bill) the United States to work bilaterally and multilaterally (through the IMF and WTO) to ensure the exchange rate of the US dollar with the currencies of major trading partners reflects economic fundamentals and market forces, and contributes to growth of and balance in the international economy, and identifies currency management as a potential hidden or unfair subsidy.
- Eliminates (in section 102(b)(1) of the bill) the need to prove intent when designating a country a currency manipulator, ie, removes the statutory requirement for proof that a country manipulates its exchange rate for the purpose of preventing an effective balance of payments (BOP) adjustment or gaining an unfair trade advantage.
- Requires (in section 102(b)(1)) the Department of the Treasury to designate a country as a currency manipulator if it (regardless of intent) influences its exchange rate in a way that (1) prevents effective BOP adjustment, (2) obtains an unfair competitive advantage for the country in international trade, and (3) results in the country accumulating substantial dollar reserves.¹⁴³
- Further requires (in section 102(b)(2)) the Treasury Department to take action against a country it brands a currency manipulator if that country has (1) a “material” global current account surplus, (2) “significant” bilateral trade surpluses with the United States, and (3) engaged in “prolonged,” one-way “intervention” in currency markets.
- Specifies the action the Treasury Department must take, namely (*in seriatim*) (1) establishing a plan of action and report to Congress, (2) negotiate bilaterally with the country, (3) coordinate efforts with

exchange markets.” This definition is susceptible to the critique made of S 1677 below, namely, it is ambiguous and result-oriented.

¹⁴¹ See Amy Tsui and Yu-Tzu Chiu, “Senate Banking Panel OKs Currency Bill; Jurisdictional Issues Remain Unresolved”, 24 *International Trade Reporter* (BNA) 1147–1148 (9 August 2007).

¹⁴² See 22 USC §5303.

¹⁴³ See Amy Tsui, n 139 above.

the IMF to pressure the currency manipulating country to adjust its exchange rate, and (4) initiate an action in the WTO pursuant to GATT Article XV.

Whether absence of the *mens rea* element in “manipulation” would embolden the Treasury to render affirmative findings is uncertain. The Committee has jurisdiction over the Department of the Treasury, but not the USTR, International Trade Commission, or Department of Commerce. The bill, therefore, must eschew trade remedies (or be devised in partnership with the Senate Finance Committee).¹⁴⁴

Conceptually, in terms of justice as fairness, the key point is the Dodd-Shelby bill does little to define actionable currency manipulation. First, does “manipulation” necessarily embody conscious, purposeful behavior? After all, *manus* (or *manipulus*) is the Latin root of “manipulate,” and corresponds to “hand” (“handful”).¹⁴⁵ That is, setting aside entirely involuntary hand motion, does the bill manipulate the very meaning of the term?

Second, the three criteria in the bill for identifying a currency manipulator are ambiguous. What factor (among others) “prevents” BOP adjustment? What kind of competitive advantage is “unfair,” and when is it gained? What dollar currency reserve level is “substantial,” and how that level gauged if a foreign country (like China) treats the denominations of its reserves as a state secret? The ambiguities, moreover, are result-oriented, failing to account for the way in which a result occurs. Should the nature of the economic activity generating reserves matter, ie, would dollar reserves from oil exports from the Kingdom of Saudi Arabia be treated differently from the sale proceeds of manufactured merchandise shipped from China?

Third, the three criteria triggering legal action are eminently malleable. What is a “material” global current account surplus? What is a “significant” bilateral surplus? What is “prolonged intervention”? Suppose the term “surplus” were changed to “deficit” in the bill, and China implemented the proposal. Might China then be able to target the United States? In other words, is the bill unfairly asymmetric, demanding unilateral legal action only for one kind of imbalance, and only for one side of a trade relationship?

¹⁴⁴ This fact might explain why the steps the Treasury Department would have to take under the Dodd-Shelby bill are not that different from the measures under present law. Essentially, under the 1988 Act, suppose the Treasury Department determines a country manipulates its currency, and that country has a material global current account surplus and a significant bilateral trade surplus with the United States. Then, absent a serious impact on American national economic and security interests, the Department must initiate expedited negotiations with that country, either bilaterally or through the IMF, so that the country adjusts its currency for an effective BOP adjustment and elimination of its unfair trade advantage.

¹⁴⁵ See Oxford English Dictionary, available online at <http://www.oed.com>.

Finally, nothing in the Dodd-Shelby proposal links actionable behaviour by China, on the one hand, with accepted economic wisdom, on the other hand. In particular, the theory of Purchasing Power Parity (PPP) holds that exchange rates, in the long run, should equalise differences in the price of a common basket of goods and services in different countries that may be traded between those countries. Intuitively, that is because arbitrage will occur to eliminate any opportunities to buy the basket at a cheap price in one country, and sell the basket at a high price in another country.¹⁴⁶ The famous popular application of the theory is *The Economist's* "Big Mac Index," a measure of "how far currencies are from *fair value*."¹⁴⁷ The Index posits a single-commodity basket, the Big Mac, and sets the US dollar price of the McDonald's hamburger as the benchmark. The implied PPP exchange rate is the value of a foreign currency relative to the dollar that would make the dollar price of a Big Mac the same in a foreign country as in the United States.

For instance, on 7 July 2007, a Big Mac cost US\$3.41. It cost 11 yuan in China, or US\$1.45 at the then-prevailing rate of 7.59 yuan per dollar. PPP theory asks the following question: what would the yuan-dollar rate have to be for the Big Mac to cost US\$3.41 in China, as it does in the United States? The answer is 3.23 yuan per dollar. That answer suggests the yuan is deeply undervalued – nearly 58 per cent (the percentage difference between 3.23 and 7.59 yuan per dollar). But, as *The Economist* rightly hastened to add,

"before China's critics start warming up for a fight, they should bear in mind that PPP points to where currencies ought to go *in the long run*. The price of a burger depends heavily on local inputs such as rent and wages, *which are not easily arbitrated across borders and tend to be lower in poorer countries*. For this reason, PPP is a better guide to currency misalignments between countries at a similar stage of development."¹⁴⁸

¹⁴⁶ PPP is the oldest theory to determine the fair value of a currency. See "Precisely Wrong", *The Economist*, 25 June 2005, at 76. To illustrate, consider the Big Mac example discussed above. Suppose the Big Mac could be bought in yuan, at 11 yuan, or US\$1.45, in China, transported to America without spoilage, and sold in the United States in dollars at US\$3.41. Arbitrageurs would see this opportunity to buy Big Macs "low" and sell them "high." To implement their strategy, however, they must purchase yuan, because they need the Chinese currency to buy Big Macs in China. Arbitrageurs sell dollars (and possibly other hard currencies) to obtain the yuan. The yuan buying activity of the arbitrageurs puts upward pressure on the yuan, and correspondingly downward pressure on the dollar. Absent government controls, the exchange rate cannot stay at 7.59 yuan per dollar. Rather, under the buying pressure, the yuan must appreciate against the dollar. In the long run, this appreciation wipes out any profit from buying a Big Mac at a low price in China and selling it at a high price in the United States. Specifically, when the exchange rate hits 3.23 yuan per dollar, the cost of obtaining yuan to purchase a Big Mac in China offsets any profit from selling it in the United States. Put differently, the price of the hamburger in the two countries effectively is equalised by the exchange rate.

¹⁴⁷ "Sizzling", *The Economist*, 7 July 2007, at 74.

¹⁴⁸ *Ibid.* (emphasis added).

Accordingly, American legislative efforts to define currency misalignment would need to incorporate both PPP and its limitations (or, at least, direct the Treasury Department to do so). A definition premised on accepted economic precepts, and any consequent legal action against China, would be more just, in the sense of more fair, than a statutory regime that confers considerable discretion, via equivocal language, to the Treasury Department.

Even better, those efforts also would account for alternative ways of gauging currency misalignment, not all of which point to an undervalued yuan. For example, there is the Fundamental Equilibrium Exchange Rate (FEER) method of ascertaining the fair value of a currency.¹⁴⁹ FEER asks what rate would be consistent with (1) external balance, ie, a sustainable current account balance (which could be a surplus or deficit), and (2) internal balance, specifically, full employment and low inflation. A 2005 study (by Virginie Coudert and Cécile Couharde of the French international economics institute CEPII) shows the yuan is undervalued by 44 per cent against the dollar. A 2006 study (by Morris Goldstein of the Institute of International Economics (IIE) in Washington, DC), using the FEER method, estimates undervaluation at 15 to 25 per cent. Both studies operate on the assumptions China has (1) a sustainable overall current account deficit (in the first study, of 1.5 per cent of GDP), and (2) nearly achieved an internal balance. However, both assumptions are questionable. First, if China liberalises its capital account, then Chinese savers may seek to invest abroad, and thereby diversify risk in their asset portfolios. The result could be a sustainable current account surplus, coupled with a capital account deficit. Second, with about 400 million unemployed or under-employed peasants of zero or marginal productivity – labour surplus, in the language of the Fei-Ranis Model¹⁵⁰ – is China truly at full employment? In brief, if China's macro-economy is unbalanced because it is not at full employment, then currency depreciation may help it toward internal balance, even though the studies estimate the yuan is undervalued.

Still another methodology for assessing the fair value of a currency is called the Behavioural Equilibrium Exchange Rate (BEER).¹⁵¹ The starting point here is to ask what economic variables, based on historical experience as well as theory, most affect the exchange rate for a currency? Once these independent variables are identified, then the current value for each variable is plugged into an equation to estimate what the exchange rate should

¹⁴⁹ The discussion of FEER is drawn from "Precisely Wrong", *The Economist*, 25 June 2005, at 76.

¹⁵⁰ This Model is explained in Raj Bhala, *Dictionary of International Trade Law* (LexisNexis, 2008) (entry for "Fei-Ranis Model") 181–189.

¹⁵¹ The discussion of BEER is drawn from "Precisely Wrong", n149 above.

be, which is the dependent variable. For the yuan (specifically, its real exchange rate), the most influential determinants are (1) productivity growth in China, (2) government budget balances of China compared to those balances in other countries, and (3) net foreign assets owned by China. A 2005 BEER study (by Stephen Jen, an economist at the Wall Street-based investment bank, Morgan Stanley) shows the yuan is undervalued by only seven per cent against the dollar. Another study (by economists at another Wall Street investment bank, Goldman Sachs) says the yuan is undervalued by 10 per cent.

Manifestly, three methods for gauging the fair value of a currency – PPP, FEER, and BEER – produce a considerable range of estimates. What, then, is the “fair” value of a currency, against which to judge whether that currency is fundamentally misaligned? Is it preferable, in the sense of objective technical accuracy, to take an average of estimates from different methodologies? Once a fair value is agreed, what degree of swing away from that value is rightly said to show manipulation? Regrettably, the American legislative efforts on defining currency manipulation do not contemplate these issues. That omission strongly intimates the efforts are biased in one direction – against China.

Contemplating a blatantly illegal tariff surcharge

One hallmark of a just trade empire is its refusal to entertain protectionist measures that contravene multilateral disciplines it has championed. Doing so indicates a willingness to abandon legal principle, even the rule of law itself, for economic and political expedience. Following rules, especially rules a country has helped write or champion, only when convenient is unfair. Yet, in February 2005, during the first session of the 109th Congress, the United States Senate proposed legislation – section 295 – that would impose a 27.5 per cent tariff on Chinese imports if China failed to revalue the yuan against the dollar within six months from the date of enactment.¹⁵² This tariff surcharge would apply across-the-board to all Chinese products. It easily would breach two pillars of the General Agreement on Tariffs and Trade (GATT).

In other words, section 295 was a legally inept proposal sponsored by two Senators, Charles Schumer (Democrat–New York) and Lindsay Graham (Republican–South Carolina), which ran afoul of a document to which the United States was an original contracting party, played a key role in drafting, and historically was a champion of the principles and doctrines

¹⁵² See Wayne M. Morrison, *CRS Issue Brief for Congress: China–US Trade Issues* (Congressional Research Service, 1 July 2005) 10–11 (explaining the proposed bill).

it embodied.¹⁵³ These prominent legislators actually had proposed the exact same bill about two years earlier, in September 2003.¹⁵⁴ The House of Representatives later resurrected their idea, in the first Session of the 110th Congress in February 2007, via HR 1002, sponsored by Congressman John Spratt (Democrat–South Carolina) and Congresswoman Sue Myrick (Republican–North Carolina).

All three iterations of the tariff surcharge bill – Graham–Schumer I of September 2003, Graham–Schumer II of February 2005, and the Spratt bill of February 2007 – are virtually identical, and can be treated as a single legislative approach. The approach bears four hallmarks:

- The bills (in their opening section) assert that artificial pegging of the yuan to the dollar is significantly below the market value of the yuan, and the degree of significance is between 15 and 40 per cent.
- The midpoint of that range is 27.5 per cent *ad valorem*. Thus, the bills (again in their initial section) take the average degree of undervaluation as the tariff surcharge figure.
- The punitive surcharge would apply to any article imported into the US from China.
- The bills (in their opening section) justify the surcharge under GATT Article XXI. In other words, anticipating and seeking to slam down a GATT–WTO challenge, the surcharge is necessary to essential American national security interests. Those interests, in specific, are protecting the US manufacturing base.

Manifestly, the bills suffer from no less than four serious defects. These defects support the argument that a 27.5 per cent tariff surcharge is an unjust – specifically, unfair – response to the challenge of the Chinese yuan.

First, the tariff surcharge would violate the most-favoured nation (MFN) obligation of GATT Article I:1. That is because the added levy would apply only to products exported from or through China, not to merchandise from other Members of the WTO.¹⁵⁵ The defence of Article XXI simply is unconvincing. That Article covers weaponry (guns), not industry (butter).

¹⁵³ Fortunately, in September 2005, the United States was spared the embarrassment of world-wide castigation, and the near-certainty of a successful WTO challenge. The co-sponsoring Senators agreed to suspend their proposal, after meeting with Treasury Secretary Henry Paulson. See Jin Ron, “US Senators Drop Bill to Slap Levy on Chinese Goods”, *China Daily*, 30 September 2006 (reporting on the meeting among the Senators and Secretary). While the Secretary’s appeal for a delay worked, his assurance the Administration could and would handle the yuan-dollar issue was by no means an enduring cure to stumbling legislative initiatives. Indeed, the subsequent bill evinced just how short-lived the hiatus was.

¹⁵⁴ See S 1586, 108th Congress, 1st Session, 5 September 2003, with additional co-sponsors.

¹⁵⁵ See Raj Bhala, *Modern GATT Law* (London: Sweet & Maxwell, 2005) Ch 3.

Second, the extra imposition would violate the tariff binding obligation of Article II:1(b). For some (though not all) Chinese imports, the addition of a 27.5 per cent tariff to the MFN duty rate would yield an applied rate in excess of the bound rate to which the United States is committed in its tariff schedule.¹⁵⁶ To be sure, GATT offers a way to modify tariff schedules. GATT Article XXVIII calls for notification, consultation, and compensatory adjustments.¹⁵⁷ Failing to use that procedure arguably could constitute a violation in itself (albeit, perhaps, one of non-violation nullification or impairment under GATT Article XXIII:1(b) and Article 26:1 of the DSU. GATT Article XXV:5, and Article IX:3-5 of the WTO Agreement, also offer the possibility of a waiver from obligations. Manifestly, getting a waiver from fellow Members is not contemplated in the Senate bill.¹⁵⁸

Third, the bills appear arbitrary on fundamental quantitative points. Why is 27.5 per cent the correct calibration? Is 15 to 40 per cent an accurate gauge of the range? What happens if relevant foreign exchange markets shift in dramatic or long-term ways?

Fourth, the bills omit key details as to their scope, suggesting they are at best strategically ambiguous, or at worst hideously vague. The bills do not set out a rule of origin to determine whether merchandise originates in China. Indeed, they do not seem to care about the matter. Whether an article comes through China, directly or indirectly into the US, is enough to attract the surcharge. That is true even if an American-owned business makes the article. Notably, whether goods shipped from or through Hong Kong or Macau also would be hit with the extra tariff is unclear. In all likelihood, given the general Congressional sentiment that Taiwan is a separate country from China, as well as its separate currency and bilateral trade account with the US, the bill would not apply to articles coming from or through Taiwan. Yet, could not similar logic, as to currency and trade accounting, apply to the Special Administrative Region (SAR) of Hong Kong?

¹⁵⁶ *Ibid.*, Ch 11.

¹⁵⁷ *Ibid.*, Ch 12.

¹⁵⁸ Interestingly, in 1971, the United States imposed an across-the-board tariff surcharge of 10%. President Richard M. Nixon took that action, under emergency powers delegated by Congress, to deal with a balance of payments (BOP) crisis. That crisis was in the context of President Nixon's decision to close the "gold window," ie, end the convertibility of US dollars into gold (at the rate of US\$35 per ounce). The surcharge led to a case, *United States v Yoshida*, 526 F 2d 560 (CCPA 1975), in which the President's authority was challenged – unsuccessfully. No GATT action was brought, and the levy proved successful enough that the President removed it in approximately three months. A GATT Article I:1 claim might have fared rather poorly, as the surcharge applied to imports from all countries, including all GATT contracting parties. However, Article II:1(b) likely would have been the legal basis for a strong claim – as it would be against the Senate bill targeting Chinese goods. A defence, of course, would have been Article XII.

Applying countervailing duties to non-market economies

One hallmark of a just trade empire is its forswearing unilateral and expedient expansion of the application of rules, notably those rules the scope of which it previously and purposefully limited. “Going it alone” in a self-serving manner is presumptively unfair. Accordingly, Uruguay Round negotiators carefully crafted the SCM Agreement to differentiate prohibited, actionable, and non-actionable subsidies from one another – the Traffic Light System. These rules are designed to accommodate a question such as whether an undervalued currency is an unlawful “Red Light” export subsidy or potentially actionable “Yellow Light” subsidy. Is yuan undervaluation a prohibited export subsidy, and is the United States trying to re-write anti-subsidy rules by itself to secure its own interests?

In July 2005, the House of Representatives considered a bill – HR 3283,¹⁵⁹ entitled the United States Trade Rights Enforcement Act – that would allow American companies to bring CVD cases against exporters and importers of unfairly subsidised merchandise from China. (A companion bill, of the same title and content, was introduced into the Senate.¹⁶⁰) The bill (in section 2) explicitly would apply CVD law to behaviour by NME countries. The bill (in section 2) targets both China – and Japan – for currency manipulation.¹⁶¹ Indeed, the bill (in section 3) explicitly changes the relevant American statutory language – the definition of a “countervailable subsidy” to spotlight China and instruct the administrative authority¹⁶² – to use methodologies for identifying and measuring the benefit of a subsidy estimate. Put bluntly, the bill authorises the Department of Commerce or International Trade Commission to use its best guess on whether China subsidises subject merchandise and by how much. In so doing, the bill would explicitly overrule the famous 1986 decision by the Court of Appeals for the Federal Circuit in *Georgetown Steel*.¹⁶³

The bill would reverse policy the Department of Commerce had maintained since 1984 not to impose CVDs on NMEs. (The Department considers China an NME.) That policy was based on the Department’s view that subsidies in communist economies like China, the former Soviet Union, and the former Czechoslovakia, do not have a measurable economic impact. That is, subsidies are so pervasive in command economies that it is

¹⁵⁹ Introduced on 28 July 2005, into the 109th Congress, 1st Session.

¹⁶⁰ See *United States Trade Rights Enforcement Act*, 109th Congress, 1st Session, s 1421. Interestingly, the Senate version was introduced on 19 July 2005, before the House bill, contrary to the usual pattern.

¹⁶¹ Like many other legislative proposals, this bill (in s 5) also identified China’s inadequate intellectual property (IP) enforcement efforts, plus (in s 8) mandated the International Trade Commission to publish a comprehensive review of Sino–American trade relations.

¹⁶² See 19 USC §1677(5).

¹⁶³ See 801 F 2d 1308 (Fed Cir 1986).

practically impossible, thought the Department, to identify separately their amount or benefits conferred by a government to a specific producer-exporter controlled by that same government. Subsequently, in 1986 decision, the Federal Circuit handed down *Georgetown Steel*.

In March 2007, the Department of Commerce announced a major shift in CVD policy.¹⁶⁴ No longer would it refrain from imposing CVDs on merchandise from NMEs. Since the 1986 *Georgetown Steel* decision, NMEs effectively were exempt from application of CVD law. The policy rationale was that it is difficult to identify an illegal subsidy with specificity in an economy dominated by the state. That is, the public-private distinction in an NME is non-existent, or nearly so, meaning there are subsidies in virtually every nook and cranny of the economy. Hence, calculating the value of a state subsidy that is particular to an entity, which is the basis for ascertaining the appropriate amount of a CVD, is difficult if not impossible.

Why change this long-standing policy? A political answer is pressure from the 2005 bill, and before that legislation proposed in 2003, prompted a bureaucratic re-think. An economic justification, however, exists. The Department of Commerce accepted that the government of China still has control over the economy of that country. Yet, since the mid-1980s, the influences of market forces and globalisation meant its control was less pervasive in breadth, less strict in depth.¹⁶⁵ For example, prices in many goods and services markets, and wage rates in various labour markets, moved

¹⁶⁴ See Memorandum from Shauna Lee-Alaia and Lawrence Norton, Office of Policy, Import Administration, US Department of Commerce, to David M. Spooner, Assistant Secretary for Import Administration, US Department of Commerce, "Countervailing Duty Investigation of Coated Free Sheet Paper from the People's Republic of China – Whether the Analytical Elements of the Georgetown Steel Opinion are Applicable to China's Present-Day Economy", C-570-907, 29 March 2007 (Investigation Public Document), posted at <http://ia.ita.doc.gov/download/cfsp/china-cfs-georgetown-applicability.pdf> (March 2007 Department of Commerce Georgetown Steel Memo).

The first Federal Register notice of Coated Free Sheet Paper from China was published on 9 April 2007 at 72 Fed Reg 17, 484. In October, the Department of Commerce rendered final affirmative CVD (and AD) determinations on Chinese (as well as Korean and Indonesian) glossy paper (which is used in art books, annual reports, catalogues, magazines, and textbooks). The Department of Commerce found Chinese producer-exporters received net countervailable subsidies between 7.4 and 44.25% (and dumped glossy paper at margins of 21.12 to 99.65%). The petitioner was NewPage Corp of Dayton, Ohio, which observed that more than 20% of industry capacity was shut down during the period of investigation (POI). However, on 20 November 2007, the International Trade Commission voted 5 to 1 against imposing CVDs (and AD duties) in the case, rendering a final negative injury determination. See 72 Fed Reg 60,645 (25 October 2007) (Department of Commerce final determination); "Coated Free Sheet Paper from China, Indonesia, and Korea", (Investigation Nos 701-TA-444-446 and 731-TA-1105-1107 (Final), US International Trade Commission Publication 3965 (November 2007); "ITC's Negative Injury Ruling Nixes Duties in Groundbreaking Subsidy Case with China", 24 *International Trade Reporter* (BNA) 1701–1702 (29 November 2007). There have been (as of December 2007) four additional CVD investigations of Chinese merchandise: Circular Welded Carbon-Quality Steel Pipe, 72 Fed Reg 36,663 (5 July 2007); Light Walled Rectangular Pipe and Tube, 72 Fed Reg 40,281 (24 July 2007); Laminated Woven Sacks, 72 Fed Reg 40,839 (25 July 2007); Certain New Pneumatic Off-the-Road Tires, 72 Fed Reg 44, 122 (7 August 2007).

¹⁶⁵ See March 2007 Department of Commerce Georgetown Steel Memo, at pp 4–11.

flexibly (if not freely). Chinese citizens had enhanced access to foreign currency and credit markets. Personal property ownership and entrepreneurial ventures, including independent decision-making by the captains of private Chinese and foreign businesses, were encouraged – and, importantly, protected by new laws. To be sure, China still was an NME (in the eyes of the Department), but one with an “n” on “non-” that is small and rapidly shrinking.¹⁶⁶

The Hunter–Ryan bill (HR 2942), formally entitled The Currency Reform for Fair Trade Act of 2007, is a second iteration of the strategy to whack Chinese products with CVDs.¹⁶⁷ Introduced on 28 June 2007 into the 110th Congress, first Session, this 34-page bill (as against earlier bills typically running three to five pages) embodies broad changes, with legal specificity, and thereby connotes a more determined and dramatic legislative response than previous proposals:

- The bill (in section 101) protects both agricultural and manufacturing goods produced in the US from subsidised Chinese competition, and identifies the American farm and industrial bases as vital to national security.
- The bill (in section 101) specifically references a wide set of international obligations to which the US must hold China accountable, including Articles VI, XVI, and XVI of GATT, the WTO SCM Agreement, and Articles IV and VIII of the IMF Articles of Agreement.
- The bill (in section 103) defines a “fundamental and actionable misalignment of a currency” according to a two-pronged test: (1) the prevailing real effective exchange rate of an exporting country is undervalued relative to the equilibrium real effective exchange rate of that country; and (2) the amount of undervaluation exceeds five per cent and has consistently done so for 18 months, because of any one of four reasons – (a) protracted, large-scale (government) intervention in the currency exchange markets, (b) excessive reserve accumulation, (c) restrictions on or incentives for the inflow or outflow of capital that is inconsistent with currency convertibility,

¹⁶⁶ The American trade statute laying out criteria for NME status is s 771(18)(A) of the Tariff Act of 1930, as amended, 19 USC §1677. The March 2007 DOC Georgetown Steel Memo (at pp 2–4) applies these criteria.

¹⁶⁷ It also is the second iteration of a proposal from Congressman Duncan Hunter (Republican–California) and Tim Ryan (Democrat–Ohio). The first version is The Chinese Currency Act of 2005, HR 1498, 109th Congress, 1st Session, 6 April 2005. The notable differentiating features of the first version is it covers safeguard actions (changing the definitions of “critical circumstances” and market disruption”), and it erodes the market–non-market economy distinction (by applying remedies to market economies, NMEs, or economies that are mixed).

or (4) any other policy or action by the exporting country. Both prongs must be satisfied to justify CVD action against a NME. The first prong is nearly superfluous, as there would be no interest in a trade remedy but for undervaluation. The second prong is easy to meet. The first reason sets a nearly *de minimis* level of undervaluation. The fourth reason is a catch-all provision.

- The bill (in section 103) essentially and unilaterally declares a misaligned currency a “countervailable subsidy” within the GATT–WTO framework. In that framework, a prohibited (Red Light) or actionable subsidy (Yellow Light) consists of four key ingredients – it is a (1) financial contribution, (2) from a government, (3) that confers a benefit, and (4) is specific to an enterprise (or industry) or group of enterprises (or industries).¹⁶⁸ Accordingly, first, the bill defines “fundamental and actionable misalignment of” currency to be a financial contribution (from the issuing country). Second, the bill explains that if the price of subject merchandise in US dollars is less than what the price would be without the misalignment, then a benefit is conferred. Third, the bill deems the benefit to be specific. All three points are irrebuttable presumptions associated with currency undervaluation. The remedy then is automatic – imposition of a CVD on subject merchandise from the exporting country issuing the currency, including one that is a NME.¹⁶⁹

Linking the bilateral trade deficit with China to American job loss, manufacturers and labour groups in the United States generally support this remarkable bill: “The AFL–CIO [American Federation of Labor–Congress of Industrial Organizations] called for immediate passage of HR 2492...”. “US manufacturing is drowning in the red ink of the US trade deficit with China,” AMTAC [the American Manufacturing Trade Action Coalition] said. The group said that the trade deficit correlated directly to many of the

¹⁶⁸ See SCM Agreement, Art 1. The bill amends the definition of “countervailable subsidy” in US trade law at 19 USC § 1677(5).

¹⁶⁹ The bill (in s 207) threatens additional remedies against a country that persistently fails to eliminate the fundamental misalignment of its currency, if the Secretary of the Treasury designates that currency for priority action. There are 9 such remedies, any one or more of which the US can pursue: (1) bilateral consultations with the target country; (2) advice from the IMF; (3) joint action with other governments in a multilateral forum; (4) formal IMF action; (5) limitations on financing of projects in the target country by the Overseas Private Investment Corporation (OPIC); (6) exertion of negative influence on financing to the target country government by multilateral development banks; (7) action by the USTR to file suit at the WTO against the target country; (8) instruction to the Board of Governors of the Federal Reserve to take action in foreign exchange markets (in coordination with the IMF); and (9) exertion of negative influence as to the membership of the target country (specifically, the voting shares allotted to it) in international financial institutions. These additional remedies adduce the scope and force of the bill as against earlier legislative proposals to deal with yuan undervaluation.

3.4 million U.S. manufacturing jobs lost since 2001 when China joined the WTO.¹⁷⁰

Yet, two features of the bill – unilateralism and subjectivity – evince it is manifestly unjust, in the sense of unfair.

First, a sole WTO member is making the judgment unilaterally as to whether currency undervaluation counts as an actionable subsidy. That member is not calling for negotiations through the WTO Committee on Subsidies and Countervailing Measures. It is not calling for the topic to be added to the agenda at a WTO Ministerial Conference meeting. The bill is America's attempt to write trade rules the rest of the world must follow to resolve its bilateral current account hole with one country.

Second, the unilateral definition of “fundamental and actionable misalignment” is dubious as to its logic (especially gauged by an un-amended SCM Agreement). Whether an under-valued currency objectively should be called a “subsidy” is uncertain. Context matters. Does the Hunter–Ryan bill inject short-term subjective preference at the expense of enduring principle? Perhaps there is no official government action, in that there is no transfer from a government of a tangible benefit. Perhaps the benefit is generally available to all enterprises and industries, not specific (in any rigorous sense of the adjective) to any sector. State action and the specificity test are cornerstones of the definition of “subsidy” in Articles 1 and 2 of the SCM Agreement.

Even if currency undervaluation is a “subsidy,” it is not certain whether it ought to be a prohibited (ie, Red Light) one. Position matters. There are direct benefits conferred to the importing country, particularly consumers of the subsidised product. There are indirect benefits to that country, if the subsidy keeps tens of millions of workers in the exporting country gainfully employed, out of poverty, free from violence, and on infertile grounds for extremist messages. Further, as a practical drafting matter, whether it is necessary to call currency undervaluation a prohibited subsidy is in doubt. Do Article 3 and annexed Illustrative List of Export Subsidies (perhaps Items (b) or (j)) cover currency undervaluation?¹⁷¹

Changing the rules on the dumping margin calculation

One hallmark of a just trade empire is its championing of multilateral venues to re-evaluate, and when agreed by consensus re-write, rules it believes are unsatisfactory. Behaving in accordance with rules established and

¹⁷⁰ Quoted in Amy Tsui, “Trade Deficit Data Prompt Renewed Calls for China Currency Bill to Move this Year”, 25 *International Trade Reporter* (BNA) 271 (21 February 2008).

¹⁷¹ One article concludes China's currency regime probably is not a Red Light subsidy under these provisions. See Matthew R. Leviton, Comment, “Is It A Subsidy? An Evaluation of China's Currency Regime and its Compliance with the WTO”, (2006) 23 *UCLA Pacific Basin Law Journal* 243–267.

accepted by the international community is a fair way of interacting with that community. That is all the more true when it is the United States that eschews derogation or deviation from the consensus, simply because it is the unequalled imperial power in that community best able to go-it-alone with least short-term cost. Historically, the United States has been indispensable in creating and advocating an international trade regime for that community, the GATT–WTO system. Conversely, solo construction of rules by the United States, which would have multilateral repercussions, is orthogonal to the content and spirit of that system, and thus unfair.

Nevertheless, redefining rules unilaterally is precisely what four prominent American Senators, Max Baucus (Democrat–Montana), Charles S. Grassley (Republican–Iowa), Charles Schumer (Democrat–New York), and Lindsey Graham (Republican–South Carolina), proposed in May 2007. They introduced legislation to permit companies to seek imposition of anti-dumping (AD) duties on Chinese products on the basis of an undervalued currency. In July 2007, two leading Democratic Presidential candidates, Senators Hillary Clinton (Democrat–New York) and Barack Obama (Democrat–Illinois), neither of whom is regarded as a protectionist or isolationist, backed the bipartisan bill.¹⁷² The bill, called the Currency Exchange Rate Oversight Reform Act of 2007 (S 1607), was introduced into the first Session of the 110th Congress on 13 June 2007. The 26-page proposal passed the Senate Finance Committee by a 20 to 1 vote, in late July, just before the August 2007 recess. (Notably, Senator Maria Cantwell (Democrat–Washington) cast the single “no” vote, saying the bill would not push China to move fast enough to a market-determined exchange rate.¹⁷³)

The touchstone of the bill is to impose AD duties on merchandise from a country the currency of which is misaligned against the US dollar.¹⁷⁴ The bill, while not restricted to imports from any one country, clearly is aimed at Chinese merchandise. The bill alters the dumping margin calculation, easing the ability of an investigating authority – the Department of Commerce to render an affirmative finding of dumping. The key statutory change would be an explicit mandate to adjust that calculation for exchange rate undervaluation. Specifically, when computing a dumping margin, it would be necessary to adjust Export Price (EP) or Constructed Export Price (CEP)

¹⁷² Eoin Callan, “Clinton and Obama back China Crackdown”, *Financial Times*, 6 July 2007, at 1.

¹⁷³ See Amy Tsui, “Senate Finance Panel OKs Currency Bill Aimed at Valuation of Chinese yuan”, (2007) 24 *International Trade Reporter* (BNA) 1101–1102.

¹⁷⁴ The Hunter–Ryan bill (HR 2942), The Currency Reform for Fair Trade Act of 2007, introduced on 28 June 2007 into the 110th Congress, 1st Session, also mandates (in s 102(c)) an adjustment to Export Price or Constructed Export Price for a fundamentally misaligned currency, and lists such a currency as actionable under AD law. However, the focus of the HR 2942, in contrast to s 1607, is on CVD reform in the NME context.

for undervaluation of a currency relative to the US dollar.¹⁷⁵ Accordingly, section 6(a)(1)(A) of the bill states:

“The administering authority shall ensure a fair comparison between the export price and the normal value by adjusting the price used to establish export price or constructed export price to reflect the fundamental misalignment of the currency of the exporting country.”¹⁷⁶

Article 2:4 of the WTO Agreement on the Implementation of Article VI of GATT 1994 (the Antidumping Agreement) requires a “fair comparison” between Normal Value and Export Price (or Constructed Export Price). Toward that end, this Article authorises adjustments to the dumping margin variables to account for differences of levels of trade, circumstances of sale, and other factors that affect the comparability of prices. There is no express permission to adjust Export Price (or Constructed Export Price) for currency undervaluation.

The strongest argument the proposed legislation is consistent with the Antidumping Agreement is the language of that Agreement is sufficiently ambiguous to permit consideration of currency manipulation when computing a dumping margin. The yet stronger argument, however, on the premise of justice as fairness, is to clear up the ambiguity through the WTO. The appropriate channel would be the WTO Committee on Antidumping, which could study the matter, issue a paper about the compatibility of an adjustment for currency undervaluation with the text, and (possibly) recommend a revision (if any) to the text. The Ministerial Conference could consider any such revision, and if it approves one, then all members both would have participated in the change. They would be on clear notice the new adjustment for currency undervaluation might be used offensively against their exporters (when these exporters are respondents in foreign AD proceedings), or defensively by their domestic industries (when these industries are petitioners).

Pursuing an amendment to the Antidumping Agreement through multilateral methods is advisable for reasons beyond the aforementioned hallmarks of justice, especially participation in the procedural mechanisms of the community. Substantively, it is not clear whether a unilaterally-drafted adjustment for currency undervaluation would be fair in all cases. Consider subject merchandise for an NME like China. In AD cases involving NMEs, it is typical to use a proxy for Normal Value, namely, Third Country Price. Thus, for instance, the Department of Commerce might

¹⁷⁵ See Amy Tsui, n 139 above.

¹⁷⁶ This change would be codified in relevant provisions of 19 USC §1673 *et seq.*

use price data on merchandise from India or Thailand in lieu of data from China. When that occurs, there ought to be no reason to adjust Export or Constructed Export Price for currency manipulation – the currency being converted into US dollars is the market-determined rupee or baht, not the manipulated yuan. Requiring the Department to account for yuan undervaluation when Normal Value is derived from a surrogate country could be unfair. This kind of unfairness would be highlighted and checked in a multilateral venue – and that is a key benefit of eschewing rash unilateral legislation. Indeed, it could be conceptually ridiculous – deriving Normal Value from a Third Country with a currency other than the yuan, and also adjusting Export or Constructed Export Price for yuan undervaluation. The practical result could be a highly biased one, skewing both sides of the dumping margin in favour of AD petitioners in the United States.

Whether an adjustment is unfair in a particular case would depend on the extent to which (if any) the currency of the surrogate country accounts for undervaluation of the yuan. For instance, if the rupee or baht – as well as the dollar – is undervalued relative to the yuan, then an adjustment to Export or Constructed Export Price could be in order. The parameters for determining the adjustment need to be agreed: How is the rupee–yuan or baht–yuan cross-rate determined? How much of an adjustment is appropriate? To what variable in the dumping margin formula should the adjustment be made? Surely these questions are not best left to a single WTO member to determine.

Even if China is accepted in a particular case as the country from which to derive data for Normal Value, it is not clear an adjustment for an undervalued yuan would be fair. A threshold problem is establishing the correct valuation, which can be difficult, if not subjective. Further, the proposed legislation requires the Department of Commerce to examine only final prices, not the costs of raw materials and intermediate goods that go into making a finished product. If the yuan is undervalued, then manufacturers in China are paying more for inputs they source from overseas (typically, from Asian countries) than they would if the yuan were priced according to market forces. The higher cost of imported inputs raises the price of a finished good, before shipment to the United States. Consequently, price data in China of finished merchandise, from which the Department derives Normal Value, already accounts for yuan undervaluation, to the extent that merchandise incorporates inputs from other countries and the yuan is undervalued against the currencies of those countries. How is the Department to gauge the precise degree to which Normal Value does, in fact, include yuan undervaluation, and then determine the right adjustment to Export or Constructed Export Price? If the Department cannot do so – and even the United States Undersecretary of Commerce admitted in January 2008

the Department would be unable to administer the proposed adjustment¹⁷⁷ – then there is a risk of imposing higher costs on American consumers of Chinese merchandise than would be fair, simply because the Department over-states the dumping margin.

Consider, too, the converse situation: an adjustment for currency overvaluation.¹⁷⁸ Suppose the yuan were over-valued against the dollar. Should Normal Value be adjusted downward, to reflect the misalignment? That would appear to be fair. Indeed, it is redolent of the central criticism of zeroing, namely, disallowing non-dumped sales to offset dumped sales exacerbates artificially the dumping margin. The zeroing illustration is instructive. Left to the United States alone, zeroing would continue unchecked in initial investigations and administrative (and virtually all other) reviews. Here, too, the multilateral methodology – negotiations through WTO auspices, coupled with adjudication there if necessary – spotlights and acts against unfairness. In brief, the very fact there is no multilateral approach to the relationship between currency misalignment and dumping margin calculations is the justification to find one.

Unfairness in this sense is not what matters to the sponsors of the Currency Exchange Rate Oversight Reform Act of 2007 (S 1607). As they put it:

“little pressure can go a long way to encouraging the right policies. ...

Significantly, our bill seeks to shield US companies and workers from unfairly cheap imports from countries playing games with their currencies. We propose modernizing US anti-dumping laws to account for currency under-valuation. This step alone could help save jobs, without violating our own international trade obligations.

... When major trading partners intervene in the currency market to obtain unfair advantage, it hurts the US economy and undermines support for open international trade¹⁷⁹

Essentially, the bill sponsors intone China is the unfair actor, and if American legislation to deal with it works, unfairness at a systemic level – ie

¹⁷⁷ See Amy Tsui, “Including Currency Value in AD, CVD Margins Could Harm Impact of Stimulus, Official Says”, 25 *International Trade Reporter* (BNA) 197–198 (7 February 2008) (quoting Christopher A. Padilla, Undersecretary of Commerce for International Trade, saying “I could throw armies of people at the problem. I just don’t know how we would do what we are being asked to do,” and adding there was no evidence the adjustment would cut the bilateral trade deficit).

¹⁷⁸ Never mind this hypothetical seems today to be a remote possibility. A hallmark of crisis junkies is that they react to the events of the day, oblivious to long-term trends, possibilities, or consequences.

¹⁷⁹ Baucus *et al*, “We Must Act When Currencies Become Misaligned”, *Financial Times*, 6 July 2007, at 9.

participation, use, substance – is an external cost not worth bothering about.

Perhaps no less troubling, in terms of just behaviour by a trade empire, is hypocrisy. The Senators seemed blissfully unaware of the hypocrisy in their position: the remedy they proposed against foreign exchange intervention – AD duties – is itself a highly interventionist tactic. Indeed, their bill calls for yet more intervention than merely changes to dumping margin adjustments. Specifically, S 1607 would:¹⁸⁰

- Eliminate use of the term currency “manipulation,” and require the United States Department of the Treasury to identify foreign currencies that are “fundamentally misaligned” against the dollar. The bill changes the definition of “fundamentally misaligned” from previous legislative proposals (eg HR 2942) to “significant and sustained undervaluation of the prevailing real effective exchange rate, adjusted for cyclical and transitory factors, from its medium-term equilibrium level.” (Section 2(5).) Arguably, the identification of “medium-term” reduces the period of investigation, and the decrease could prejudice the inquiry in favour of an affirmative finding of misalignment.
- Creates a sequential plan of action for the United States government to follow that is nearly identical to the one laid out in alternative legislation (especially HR 2942). Thus, for example, the Treasury Department would be required to designate a fundamentally misaligned currency for “priority action,” if the misalignment is a result of explicit policy of a foreign government. (Section 4(3) of S 1607.) Such designation would trigger immediate, mandatory consultations between the Treasury and the relevant foreign country with a view to realigning the currency. (Section 5(a).) If consultations failed to resolve the dispute after six months, then the United States government would suspend official purchases of goods and services from that country. (Section 6(a)(2).) Continued failure to resolve the dispute could trigger a WTO dispute settlement action (eg under anti-subsidy rules), and remedial intervention in foreign exchange markets. (Section 7(a)(1)-(2).)
- The President can waive (subject to Congressional disapproval) any of the aforementioned actions based on the security or economic interests of the United States. (Sections 7(c) and 8(a).)

¹⁸⁰ *Ibid.*

In brief, the Senators meet alleged intervention with decisively more intervention – hardly the stuff of open markets. Moreover, the switch from “manipulation” to “fundamental misalignment” exalts rubric over substance. That is because a finding of explicit foreign government policies driving the misalignment is tantamount to a finding of official manipulation.

7. Important Imperial Concessions

Low marks on prudence and courage? Failing grades on moderation and justice? Albeit from only one test – responding to the challenge of the Chinese yuan – and put as a proposition, the report card for America hardly seems one of a grand trade empire. Yet, little in international trade law is clear cut. Neither virtue nor vice characterises the entirety of the aims and effects of the political and legal ways in which the American trade empire has responded to this challenge. Some American approaches to the problem incline to virtue or vice, and some may be a mixture.

For instance, the Congress ultimately elected not to stick Chinese merchandise with a 27.5 per cent tariff surcharge. Its abstention from doing so surely showed a considerable degree of prudence. As another example, the decisions of the USTR not to bring GATT Article XV:4 or SCM Agreement Article 3 challenges to China’s exchange rate regime could illustrate two positive virtues – patience and compassion. Abstention from legal challenges could manifest conscious concessions by the USTR to give China precisely what it seeks – empathetic understanding that it needs time to change its controversial regime. Most importantly, the point here is to propose, not impose, a judgment – hence the question marks in the major section headings.

That said, great empires can – and have in the past – tripped up on ostensibly modest problems. A misaligned currency and bilateral trade deficit, even with China, arguably is a modest problem in an array of difficulties America faces in the early decades of the new millennium. The thesis advanced here is not that the problem will bring down America’s trade empire. Rather, the thesis is the problem reveals the limits of that empire. In responding to China’s over-valued yuan, America demonstrates thoughtlessness, not prudence, excess, not moderation, irresoluteness, not courage, and prejudice, not justice. Those vices can – and most certainly have in the past – proved orthogonal to long-term imperial interests.

If fully apprised about the highly technical China currency issue, most Americans in Kansas and throughout the Heartland might be rather embarrassed by the responses proposed by some of their legislators. Who, other

than reviled extremists, can take delight in the suggestion that, if judged by this issue, America's trade empire might be as morally blundering as its political and military one?

Certainly, putting forth this thesis brings no joy, nor is the thesis accompanied by a wish for imperial decline or fall. To the contrary, a proposition worth considering is whether and how the global economic order might benefit from an American trade empire that embraces and practices the Four Cardinal Virtues.¹⁸¹ But, that is a proposition for another venue. For now, seeing that China's problems are our problems, and thereby are an opportunity for us to grow in our traditional virtues, might help improve perceptions – and reality, too.

¹⁸¹ Indeed, Niall Ferguson makes an even more ambitious argument in *Colossus* (n 26 above), with which the present author agrees – that the world would benefit from a liberal American empire.

