Aluisio de Lima-Campos: My name is Aluisio de Lima-Campos. I cannot pronounce my first name as well as Fred and Adam do. If you have a problem with that just call me Al like the songs says. I’m with American University Washington, The College of Law and we’re here to do the law panel.

We saw from the first panel that we do have a problem. We’re not Apollo 13 here, but we do have a problem. What is this problem? It has to do with currency misalignments it doesn’t matter how you classify it. I myself like to call predatory currency misalignments as the bad thing that we should have rules against and that this is all explained in a note that is circulated that should be in your folder there. But right now I’m in the moderator role so I’m not going to go into that and I’ll leave it to questions afterwards if that’s the case.

But the questions we need to look here at the legal panel is currency misalignments and what’s bad about them. We’ve heard that currency misalignments are a normal thing that could be market driven. The question is when are they not and when they’re not; what kind of impact you have on trade?

We saw the presentation by [inaudible 0:01:30], that clearly shows that there is a negative impact from devaluations on not only on the trade partners but also on trade rules. When we talk about trade rules is what we have today in the books is in the WTO side article 15, in the IMF side article four and from the language in article 15 that talks about frustration of the intent of the articles and on article four it talks about manipulators. So it’s a debate as to whether we can come to an agreement as to what it is a frustrator, what it is a manipulator and try to get this somehow digested and a solution produced.
The fact is that today if—let me put it another way, a more dramatic way. Say any country today can go into the WTO; agree to very low levels of bound rates and the very next day these bound rates mean absolutely nothing with a single devaluation. So, it’s a question as to whether is it worth sitting down and negotiating ten years to come to a reduction in tariffs when you can wipe that out with just a devaluation?

Second thing is it gets worse because countries use instruments at the WTO like trade remedies, anti-dumping, anti-subsidy, safeguards, to protect the markets based on rules of WTO and a single devaluation not only can wipe out tariff protection, but also any trade remedies you have on top of that. So it is clearly a significant problem. And the questions that the legal panel is going to discuss right now, hopefully will take us in the right direction in to getting to a solution.

We have a fantastic panel here for you today. We’re going to start with Gary Hufbauer, who’s the Reginald Jones Senior Fellow at the Institute for International Economics. I’ll be very brief in the introduction as I said so we can have more time for debate.

We’re going to have Michael Gadbaw currently Senior Distinguished Fellow at Institute of International Economics at Georgetown Law School and Hector Torres who’s presently at the IMF. He’s on leave from the WTO, so you have the perfect person here to give you both perspectives from the inside. Without further ado I would like to call Gary to start with the presentation.

Gary Hufbauer: Thanks Aluisio and thanks to Joe and Adam for putting this show together. I have three points and a conclusion, briefly institutional failure, the distinction between manipulation and frustration and a resurgence of the mercantilist mentality, which is never far from the trading system and the conclusion is that there is a big role for the WTO. The simple question is how the WTO role should be played? Which leaves a central question in my mind.

Institutional failures first. We’ve seen what has happened in the WTO it has failed to negotiating body over the last 12 years and that’s extremely sad and regrettable, and of course it still succeeds as a dispute settlement body its shining glory.

For the fund institutional failures in my mind that foremost are it did nothing to preempt the financial follies here in Asia, in Europe and it has done nothing on the subject of our discussion today which are currency values.
Now these institutional failures reflect the deeper unraveling of Bretton Woods, which is both a leadership problem of the respective organizations and membership problem that is the big players don’t want to take the bigger role.

Let me now turn to the distinction manipulation and frustration where there is a difference between my views and those expressed among others, like Doug Irwin. As I see the word manipulation it implies intent and that was much emphasized in the first panel. And as I see the word frustration, in Article 15 where it implies results and that's very different than intent and lawyers are quite accustomed to that distinction between intent and results.

As long as the focus is on intent there will be no systematic answer to the currency evaluation problem because finance ministries are populated with very clever people and they can always obscure the intent of what they are doing. So if you have an intent based system of course, in the fund then obviously no intent on any of the things that would have gone with currency values had a whack and the only outcome of an intent based attempt to deal with the problem will be no outcome and self-help through various methods one of which will be in the regional tax.

I think the emphasis on intent which are on manipulation, which is very strong in what Doug Irwin said, but it is also very strong in what Joe said it’s a very rear view mirror approach. Yes you can do the correlation that Joe did if that’s going to be the basis of dealing with the currency, under evaluation, over evaluation to use somewhat neutral terms.

The big growth area today is state owned enterprises. It's sovereign MIL funds, there’s so many ways that countries can influence their currencies that if you just use some definition official assets I think you will deal with the problem of the last ten years but not the next ten years.

So in my view it really doesn’t matter where the origin of the significant undervaluation is a deliberate target of the exchange rate, which nobody claims to doing, or variants of quantitative easing, or the workings of the markets. I think that Doug’s fears of stifling the good work of, and I agree, it is good work of Bernanke or Watanabe or we can take our own Adam Posen in the Bank of England. I don’t think that any efforts to shrink the extensive undervaluation are going to put a cap on any of these central bankers of our day the way the problem would be addressed is not going to impede them from dealing with the financial crisis which we periodically face.

My third point resurgence of the mercantile’s mentality. This is always present provides those of us who deal in the trade area with continuing full
employment because it’s there. In an era of slow global growth which we are seemingly in plus very large current account surpluses and deficits, this is just—feeds it like crazy.

Trade ministers anyway, are kind of merchantilist or they don’t get to their positions and the current environment with the substantial currency devaluation against the background of slow wealth growth, just makes them very strongly focused on protecting their own market, not giving up all the protection which is there, which is very substantial Jones Act, you can go right down the list, and also focuses them quite strongly on getting market access abroad and of course that creates a worldwide log jam on trade negotiations.

More importantly then what it does to the minds of trade ministers, who are responding to their constituents, it really fertilizes the popular anti trade sentiment, which is very strong in this country, or I should say, anti-trade liberalization sentiment, very strong in this country, but it also can be found elsewhere in all sorts of doubts. And it moves the whole currency discussion away from the Bretton Woods Institutions, the Fund and the WTO into, as Congress is calling for it, into the TPP and if TTEP becomes a reality; it will move there as well.

So in a broad sense I think it all adds up to frustration of the goals of the World Trade Organization and calls for WTO response.

So the big question ahead on that predicate, is whether the WTO answer can be shoehorned into the existing GATT tax and Michael Gabdaw will explain why it can or cannot or whether you need a new negotiations approach. Or whether we have a combination of national action, which leads to new negotiation, which have been very much the idea espoused by Aluisio and his colleagues in Brazil and I think that’s much commended.

Now the big objection, there are really only two big objections to moving this subject matter into the WTO. Let me talk about the weakest first, but it is important. All the candidates to replace me, I feel quite confident on going around and telling the currency under valuator, who have all been listed by Joe, that they’re not going to do anything about it. Their currency is off the table, as Vera said, it’s off the table and she was working there and they’re promising as a way of getting votes from those important countries that it will stay off the table. So that’s the lesser objection.

The bigger objection for WTO to doing anything is that finance ministries really do not want to give up any turf to WTO. That is a very, very strong objection and so they want to keep it in the IMF where they have been ineffective in the same point of view as in Brazil or very effective from the
standpoint of China and Singapore. In any event, whether effective or ineffective, they certainly don’t want to have any power with the WTO and possibly with trade ministers.

Now in the paper that was distributed this morning, Jeff Shot and I tried to somewhat square this bureaucratic problem, which is very severe with a combined IMF and WTO goal, either in the course of litigation or in the course of a new negotiation. But the real proof will come at lunch if the November election had gone differently and if Bob Zoellick was now treasury secretary the real question is whether he would take a different view on the WTO role than Tim Geithner took, which is very much opposed to any WTO role. Thank you very much.

Michael Gadbaw:

So the issue that I want to talk about, has been teed up by Aluisio, and is what is the role of international economic law in dealing with this issue of currencies and the currency role? And I’d like to start by acknowledging this is very well covered legal terrain that a lot of my very distinguished colleagues in the legal profession have already warned the WTO, in Gary's inimitable words, to stay out of the currency sandbox or who have argued quite persuasively that in dealing with currency measures where at the limits of international economic law. That this is an issue of really for a negotiation and power politics and not for lawyers.

But colleague mentor, John Jackson has also warned about the dangers of treaty rigidity in both the IMF and the WTO agreements and it’s this spirit that I think it's worth a fresh legal opinion on the whole question of how we might deal with currency wars. John has also warned about something that's been alluded to here already and that is the antagonism between trade and finance officials. Indeed, he even talks about in terms of the hatred.

At the heart of this antagonism is a difference of view around the role of rules, norms or as economists like to call the, standards as they relate to economics and economic policy. So I was encouraged when I saw Bob Zoellick’s editorial, in which he really I think, invited a fresh legal opinion on how me might look at a more rural oriented approach to this issue and his argument that the IMF and the WTO should work more closely together in developing both standards and enforcement mechanism.

And I think Bob is actually pointing the way forward in addressing the quest to what in the past has been coordination or coherence along the regulatory regimes, to what I am arguing is a convergence of around how to regulate international trade and finance.

So it’s fair to ask in looking at this, well what is change that might invite a fresh legal opinion. And if you think about the last five to seven years, I
think there are a number of things that lead us really to want to revisit this issue of how the rules can play a role in dealing with the issue of either currency manipulation or currency misalignment.

We’ve already heard this morning about the changes and thinking among economists, about the severity of the problem and its impact on trade imbalances and the impact that that is having on the integrity of the obligation of the international trading system.

We also know about the role the trade imbalances have played as a contributing cause of the systemic failure in the global financial crisis. And I think an interesting issue that is worthy of discussion is the differences in the performance of the two regulatory regimes dealing with trade and financial regulation and an acknowledgment that through this financial crisis the trading system performed extremely well, to the point where trade is not generally seen as a major source of systemic failure. And I think that’s really worthy of reflecting on.

And I think that I would add to this observation, the fact that we’ve seen an emergence of a new principal of international economic law and that is, thou shall not cause systemic failure. I’ve argued elsewhere that this rule cuts across the global regulatory regimes of international trade, monetary affairs and financial regulation. And I think the importance of preventing systemic failure has been a driving principal of the WTO and is at the heart of both macro and micro prudential regulation.

I think this principal mandates that we all look at all national and international policies through the lens that asks us; is this moving the system along the continuum toward failure or toward stability? And that be taken into account in evaluating our policies.

So when we think about the role of rules it seems to me that this issue of the appropriate alignment of currencies that has been around for a long time is a kin to a fundamental rule of the role and it was the heart of the Bretton Wood System as that system is embodied in both the IMF and the gap rules.

I think of the gold standard as really a kind of structural barriers, like we have on the highways. So we have the basic rule that you stay in your lane that you keep to one side of the road and let incoming traffic go on the other side of the road. And that simple rule allows us to have an incredible volume and speed in the movement of automobiles and in the international system, capital and products.

But when the gold standard was eliminated is was as though we took out those big brassy medians or the Jersey walls and replaced it with this
double yellow line of article four of the IMF agreement. So we now have this incredible volume of traffic moving along the global super highways, moving capital and products, but with just this double yellow line of article four keeping countries in their lanes and out of the oncoming traffic.

So the question is whether, the elusive double yellow line of article four, is sufficient. And is this a question of the rule itself, the enforcement of the rule, the fact that perhaps it’s more efficient economically and perhaps even legally to let countries move across the yellow lines when they deem it in their interest and is the yellow line just not very clear in most super highways or is it just too darn tough to get countries to stay in their lanes?

So I thought since this is the season of the basketball playoffs and I know Fred likes basketball, I thought I would use a basketball metaphor to capture the contest over what are the right rules to deal with this whole issue of currency misalignment or currency manipulation?

So I have laid out here the two big leagues, the IMF and the WTO and the sets of rules that each has to deal with this problem. And I think behind these two leagues is very different views of the nature of rules and how they work and its helpful to remember that the IMF is a kind of top down bureaucracy driven set of rules, where the obligation actually run vertically to the IMF itself, to the board of directors.

Whereas in the WTO, the obligations actually runs horizontally member-to-member and that the members themselves act as the prosecutors. It’s not like the IMF, which has a very powerful bureaucracy that can blow the whistle if you will, even if you can’t do that much about it. In the case of the WTO the members individually, but also collectively decide when it is appropriate to bring a case.

So we have a variety or provisions that we've talked about article 15(4) that has been eluded to already, “that contracting parties shall not by exchange action frustrate the intent to the provisions of the WTO.” Article 2, which Vera has talked about, governing the right to maintain that level of protection that is embodied in your tariff schedule. The provisions on subsidies, illegal export subsidies, under article 16, as well as the subsidy duty code. And then of course article 15(9) that is essentially a safe harbor for any measures, the use of exchange controls and exchange restrictions in accordance with the IMF.

Whereas on the IMF side essentially, article four but also the determination is it in accordance with the IMF rules, which the WTO has to defer to the IMF under its own rules. And so there is a critical question in thinking about the WTO rules whether you characterize currency
manipulation or misalignment as an unfair trade practice or just as something that has spillover effects that can frustrate the intent of various provisions, be they the intent of article two, to allow you to maintain the level of tariff protection to which you are entitled.

In one case if you call it an unfair trade practice, that has a lot of emotional baggage to it and kicks in the system, which itself raises a lot of questions about the controllability and is it essentially a protectionist set of measure? And so you have this debate over what’s the best tool to use under the WTO?

But ultimately it can be teed up as a playoff, if you will, between manipulation and frustration. The problem is if you set it up that way, that the IMF has a provision that it can point to in the GATT rules that acts a bit like an eight foot center on the WTO team. It's actually playing for the IMF. And that’s the way article 15(9) works because 15(9) in the GATT says, “Nothing in the GATT shall preclude the use of exchange, controls and restrictions in accordance with the IMF,” and it’s up to the IMF to make that determination.

So that’s been read to mean that the only way the WTO can find that you are frustrating the WTO rules by a currency misalignment is if you have been found by the IMF to have manipulated exchange rates in order to gain a competitive advantage. In short, to be a frustrator you have to be a manipulator.

So you’re faced with the question, well what if for some reason the IMF is unable or unwilling, perhaps for political reasons as some people have said, to call a spade to spade. Are there legal ways to get you through that knothole? And I’m suggesting that if there is the legal equivalent of political will, I would call it legal will, there might be three approaches that you might look at.

First is the textual argument. The safe harbor in article 15(9) only applies by its language to exchange controls and exchange restrictions. It does not, arguably, create a safe harbor for currency intervention itself because that is arguably not within the terms of exchange controls or exchange restrictions.

Second, there's an institutional argument. If the IMF for political reasons cannot determine that a country is manipulating its exchange rates, the WTO can take that into account, but it too has a legal obligation to protect its parties from measures that frustrate the intents of its provisions and therefore it is not precluded from providing a remedy. So it has to look to remediate that measure, even if it cannot insist that the country remove the underlying practice.
A third argument would be if the IMF cannot for political reasons, conclude that a country is manipulating its exchange rate, it could also for political reasons, decide not to conclude that the country is acting in accordance with IMF rules. This is the so-called third way argument and it’s contested by people like Sean Hagan who say, if the IMF cannot determine that you are violating the IMF rules then you must as a matter of international law, decide that you are acting in accordance with IMF rules. It’s really just two sides of the same coin. You're either a violator or not a violator.

My argument is that if that is made under a set of decision making rules that are blocked by a group that says we simply aren’t going to make that determination, couldn’t a counter group also block the determination whether they’re acting in accordance? We have a third category of countries that aren’t necessarily manipulators, but they’re not deemed to be acting in accordance with.

None of this is optimal, because the best solution would be the WTO and the IMF to come up with a negotiated solution that at some point a currency misalignment caused by massive and persistent intervention would justify WTO remedial measure. Either the negotiation of turf concessions, the imposition of a duty to countervail, the subsidy effect, or the authority to take selective safeguards and some kind of non MFM basis to address the injury.

The question therefore can be asked, what would it take to get to that kind of negotiated solution? And Aluisio has been a great advocate for saying that a concerted group, that might bring countervailing measures under their subsidy [inaudible 0:29:42] laws that might create the kind of pressure that is needed in this system to get to a negotiated solution.

Finally, I want to address a point that Fred has made which is that this whole issue of currencies is really a macro problem and therefore micro solutions which is essentially what the WTO is about, are not appropriate. In that respect I make three points.

First, the WTO is all about the micro and a micro, you get enough micro problems and you’ve got a macro problem and its very important to preserve the fairness and equity of the WTO system, particularly for those countries without other recourse and being able to do that you keep the system from moving in the direction of a systemic failure.

Secondly, even a micro solution would highlight the effects of an intervention, inappropriate currency interventions, and would generate some international pressure by publicizing the practice and its effects. And
you can see how countries react to countervailing duty measure and how that affects their internal politics.

And that’s the third point, that even micro measures can have an effect on the political economy within countries and can generate internal forces that say, “Wait a minute these measure that we are facing that are countering our policies create a reason for us to think through whether there are other ways of addressing the underlying problem without taking those measures?” That’s it. Thank you very much.

Hector Torres: Good morning everybody and thank you very much for having invited me. I have to start with a disclaimer. As Aluisio said, I’m on leave from the WTO. When I pretend to go back and I pretend to find a job, so I will be speaking strictly on my personal capacity. The same goes for the IMF, although I feel quite free at the IMF about this issue.

I would skip some slides because I think it’s a bit too long and we have to go for the discussion. But basically the first question is, could competitive devaluations or efforts to repress appreciations turn worries as the currency wars are now categorized, into wars and eventually into trade wars? And my answer is yes they could.

Particularly in this hyper liquid environment, in which, and I quote the IMF, monetary policy decisions and major advanced economies can exert a powerful influence on capital flows to emerging markets and the quantitative of easing announcement by major central banks are associated with higher capital inflows into emerging market economies.

So when our policy makers face inflows the first question that they ask themselves, is are they going to stay or are they going to reversing? No matter what those inflows will exercise pressure in exchange rate regime and one option of course, is to give in and let the exchange rate appreciate very much, I would say, in line with what the IMF tends to recommend and of course that would create immediate calls from the domestic industry to protect.

Now if you don’t give in and you resist deportation, well you intervene in the foreign exchange markets, you buy reserves and of course you try to avoid inflation by sterilizing those reserves. You encourage fiscal costs. And then you have the last resort before what I would say, are real trade wars, which is implementing effective capital control measures.

Now if capital control measures, if intervening in the foreign exchange market doesn’t work and capital controls measure don’t work, then the other thing you can do is, actually you can be very effective in restricting
trade. So that’s the point if capital controls measure don’t work then trade restrictions will necessarily be the last option and that’s a real race.

Then of course, everybody is looking at somebody who is—okay, now WTO regulations. WTO regulate members’ capacity and restrict imports and supports exports. Question is currency manipulation regulated at the WTO and what are the relevant WTO provisions? These are the questions I will address mostly in the rest of my intervention and is remedial action available according to WTO rules?

Well let’s see first article 152, which has three mostly procedural obligations to which my predecessors already referred. One is in all cases regarding foreign exchange arrangements WTO shall, this is a shall litigation, consult fully with the IMF. I don’t want to get into what the arrangements are because that would take us to another direction.

But the first question is, who is the IMF because the IMF? Because is the management, the IMF is staff, the IMF is the board. Daniel is here looking at me. And so, I would say, this I’m pretty sure, that when you say has to consult with the IMF this means that ultimately the board has to approve whatever comes out from the IMF and the board is political animal. And hear this you all know that in the IMF a bigger quarter makes bigger boats so not every country has equal saying at the board.

So the defendant, if there's a case of the WTO, and the panel ask for this opinion, the defendant and the claimant may have different weight in whatever the IMF board decides.

So question, could this raise question on the second point? Which is we have to take at the WTO whatever the IMF says provided as factual. Could it raise a question on whether it is the findings of the IMF board, if it comes out of there and I would say don't hold your breath, if they come out, could it raise the question on due process and could it raise a question of whether they are factual or not? Because as I said, it is very much conceivable that the defendant and the claimant have different weight at whatever the IMF comes up with.

So then factual, let me say one more thing on factual. Determining whether an exchange rate is undervalued requires comparing the market exchange rate with the benchmark. Now the benchmark is not an observable variable. It is a constructive variable and as any constructive variable, it depends on models and models would depend on the weight that you may give to the variables that you include in those models. So ultimately there is judgment included there.
So question, how factual is that determination? Well then, the IMF has to accept the determination of the IMF on whether action complies with IMF provisions. Yes, and as my predecessor said, it is not very clear whether the IMF can come up with any answer to this.

Now let’s look at article 154, which has a more substantial obligation. When there’s a question the contracting part is the GATT or, ‘the WTO shall not by exchange action frustrating tent of the agreement provisions’. So this is un-chartered waters, it has never been interpreted and in interpreting, we, I mean we, the panel and I will not be in that panel, I guess, mostly after this jet, will face several problems and I will address those problems.

The first is what is exchange action? I would argue it could be two things. The first is basically, regulations that restrict access to the foreign currency for the purpose for instance, of settling current transaction. This would be one, I would say, narrow interpretation, of what is exchange action.

Now it could be more than that. It could also include exchange rate action, which is intervention in the foreign exchange market. The first is closer to regulate access, the first interpretation, is closer to what the IMF calls of the concept of current payments, so regulation that will affect current payment.

The second is closer to the concept of manipulation. If we accept that exchange action includes exchange rate action and not just regulations in access, then we are closer to the terrain of manipulations at the IMF.

Now let’s look at action in the first interpretation, in the narrow one. Restriction of access to foreign exchange. Well, this is in line with the article 159, which states ‘that nothing in the GATT could preclude members from using controls or exchange restrictions in accordance with the IMF charter’.

So, therefore if the measure is consistent with IMF—if the measure is consistent with the IMF, I would say the IMF consistent use of exchange controls or exchange restrictions, should not lead to a find of breach in the WTO GATT provisions. Now, there’s a question on that and we will address that afterwards.

So let's see, when does an IMF allow for exchange controls and restrictions? And we move to the IMF. Article 6 section 1 foresees the possibility either the IMF could ask members to impose capital controls, and this is not as crazy as it sounds, because in the case of Cyprus this well maybe the case.
Article 6(3)—sorry, the first one is to avoid misuse of fund resources, for instance to finance the capital flight. Article 6(3) says it’s okay to restrict capital transfers, but not to restrict payment to current transactions and we will see what is current transactions now in the IMF definitions.

And article 8 section 2 is no restrictions on payments and transfers for current transactions should be applied, except with IMF approval. And here is some interesting difference to which my predecessors also refer to, which is the capacity of the IMF and WTO to police compliance.

There’s an interesting difference. The IMF could require members to remove restrictions affecting current transactions regardless of whether any other member that is feeling affected is submitted to the board. Anybody can do it, the management could do, take the initiative or any executive board member could take the initiative. The WTO of course not. You depend on somebody that may bring the case or not and what if they do.

We’re still under the narrow definition. What is current transaction for the IMF? Okay. Basically current transaction are capital transfer to settle current transactions. What are current transactions? Trade, interest on loans, net income. Some of these transactions are, I would say from an economic perspective, more capital in nature. It is clearly described in article 30D of the IMF chart what are the for the IMF current transactions, as we said, that cannot be restricted.

Now, I would say, that capital transactions require, of course, capital transfer, but for the purpose of transferring capital, but rather to settle trade transactions. That would be the big difference I would say.

Now not so easy because in the GATT. So we said this GATT, GATT, IMF. Now in the GATT some capital transactions that are not for the purpose of settling trading services are restricted because they are essential for certain commitments. We can see two minutes GATT, article 11 is very much in line with we said in GATT, so no restrictions in current transactions related to specific commitments.

Article 112 “exchange actions if consistent with the IMF provided they do not affect capital transactions inconsistently with specific commitments” and then it refers to a footnote eight article 16, which basically says, “if a member has undertaken a cross boarder commitment, movement of capital is essential part of that service then the member cannot restrict it.” Then that’s more restricted that the IMF provisions.
And if you undertake mode three commitments, which is commercial presence investment in the importing country, the member that undertook that commitment is committed to allow inflows of capital into his territory.

Summing up, first WTO members can use exchange controls or exchange restrictions in accordance with the IMF. This would be the case of surrender requirements or anti money laundering.

Second, IMF members can take actions to restrict capital movements, but not to restrict the use of capital or to settle current transactions except with IMF approval.

Three, WTO members cannot restrict capital movements if this is inconsistent with specific commitments in the GATT. On top, to make things a bit more complex, we have a provincial carve out in the GATT agreements, which is quite important. It says 'that withstanding any provision of the GATT members are not prevented from taking measures for prudential reasons, including to ensure the integrity and the stability of the financial system. So question for you to answer. I will not.

Now this means avoiding commitments and obligations. So the question is this, exchange rate action. So if exchange action includes exchange rate action, could it be taken to ensure the integrity and the stability of the financial system and therefore, be protected by this carve out? I don’t have an answer, but I know there is a country, a very important country that argues that intervention in the foreign exchange is necessary due to the unprecedented expansion of global liquidity as a result of monetary policy decisions in large industrial economies. You may guess who these countries are.

So, exchange rate action. Some argue that exchange rates were not really in the matter of the GATT because there was, at that time, a gold standard. Now this is not so clear because in article 15- you have article 156 and 157, that require—article 156 requires that contracting parties to a GATT become IMF members or enter into special arrangement agreements with the GATT. And article 157 provides that such special arrange agreements shall ensure that the objective of the GATT are not frustrated by action in exchange matters.

So, I would say this matches quite well with article four one of the IMF and in my humble opinion, gives the negotiators of the GATTs did have in mind the possibility that exchange rate action could be undermining trade concessions despite the gold standard.
Okay so how would a panel determine manipulation and does manipulation frustrate? Which is the question that my predecessors had addressed.

First is it a fact? Ask the IMF and I don’t breathe as I said, because I don't believe that the executive board would ever come with an answer on whether there is manipulation or not. So far we have never done it. I'm not going to say we because I'm at the board now. And is the IMF obliged to respond? Well, the answer is no. The IMF is not obliged to respond.

And what would happen then, will the panel be blocked? No the panel, in my humble option, would not be blocked. It could use article 13 of the dispute settlement understanding and require the information over to facts elsewhere.

Now, it could even us the indicators that the IMF itself has provided in the 2012 decision, which is coming from 2007 decision, called Modernizing Legal Framework for Surveillance and Integrated Surveillance Decision. It contains principals for guidelines for members and there will be a guidelines note for staff published in the next days which includes some yellow lights as protracted large scale intervention in one direction in the foreign exchange market, together with large and prolonged current account surpluses.

Now if you’re waiting for the IMF to tell you that there is manipulation, then it will be quite difficult. An IMF member would only be found manipulating exchange rates in order to gain unfair competitive advantage if first the member is engaged in policies for the purposes of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate.

And second the purpose of securing such misalignment is to increase net exports. This is in the annex of the last decision of the IMF. So I would say it is difficult than it would come.

Let’s move to what is the intent of WTO GATTs, WTO provisions? First of all it could be argued that it is creating competitive conditions, could be. Others could be its intent different to the objectives of the WTO and those you can find in the preamble. These are the things that the panel would be facing, raised standards of living, full employment, steadily growing real income, sustainable development.

Then what does frustrate mean? How do you determine frustration? Article 15(9) has indication that says that, 'in the notes, it says that the word frustrate is intended to indicate, for example that infringements to
any article via exchange actions shall not be regarded as a violation if, in practice, there is no appreciable departure from the intent of the article'.

So I would argue that contrary to sense to, infringements that entail an appreciable departure from the intent would frustrate, but still this leave us with what is appreciable departure. So maybe we need how to measure appreciable departure. Would this require to determine what is the contribution of exchange rate action to the frustration of the objectives? How to determine that? Should we do a non-attribution test as is required in safe cuts? All this is really a very messy territory and I would say that anybody can have the answer. There’s no answer that could guide me in this intervention.

This is the other question, an exchange measure consistent with the IMF could still frustrate the intent or not? Well, I would say that the only guidance I can tell you is that a former director of the Legal Department of the WTO argued in an article, this is Frieda Roesler, that this was not possible. They would not be possible—no possible conflict between Article 15(4) and 15(9) of the GATT.

Now, what is the difference between frustrate and nullify and impair that are two words that are quite familiar with the WTO? Well, I don't have an answer, but this brings us to Article 23(1b), which is the possibility that a country could bring a non-violation complaint. I would say that it's not a very attractive possibility because, a non-violation means the claimant is arguing that the defendant is using a measure that does not violate obligations, any kind of measure, but nullifies or impairs the benefit or impedes the attainments of any objective of the WTO/GATT.

Now in doing that, the complainant would lead to prove that, for instance, this large and protracted foreign exchange market intervention in one direction together with the prolonged and current count surpluses is exchange rate action that is causing the nullification of a benefit. It would also have to provide that the exchange rate misalignment is the result of the defendant's intervention.

Third, it would have to provide a non-attribution test to discern the other causes that could be contributing to nullification. All that would be quite difficult and if the complainant wins the case, the defendant would not be obliged to withdraw the measure this large scale intervention, but rather to see a mutually satisfactory adjustment or offer compensation. So I would say that it is not a very attractive.

Undervaluation as a subsidy. First question; is there a financial contribution? Now suppose, this is a hypothetical case. Suppose that the country is running a current accounts surplus and that market participants
are obliged to surrender foreign exchange to the government, or simply, they are uninterested in keeping it because due to government regulations they cannot invest in foreign assets. So in such a situation, the government would be the only buyer and it would need to buy all the excess of this supply of foreign currency.

Could it be argued that the government is paying a cost for mopping up the excess of dollars and would this cause a financial contribution? Basically, is underpricing local currency, which is overpaying for U.S. dollars a foregone revenue, for instance? I don't have an answer, but I can see the possibility that somebody can make the question that repressing appreciation is underpricing local currency and overpaying for dollars is a revenue foregone because the government could have bought those dollars for less money.

Is there a benefit? What is the benchmark? First of all, cost for the government may be argued, as I just said, but cost in not necessarily the benefit for the exporter. A cost for the government is not necessarily benefit, this comes from a Canada Aircraft case, the [inaudible 00:55:24] body made it very clear. [inaudible 00:55:24] is somewhere here could tell us if I'm lying.

Now, what benchmark should be used to prove that the measure brings the benefit, that's the other question? Would the measure be specific? That’s a difficult one because of course, importers and exporters would use the same exchange rate. However, I have a hypothetical case in which I could see an argument made. It is possible to envision situations where the claimant would find arguments to make the case for contingency on export performance.

For instance, if there is a general Forex surrender requirement, a government could support exporters by waiving them from capital restrictions that are applicable to all the other O2 or the market participants allowing exporters to retain a portion of foreign exchange earnings and purchase foreign securities or keep domestic currency abroad. They could encourage an early surrender of Forex by reusing charges related to the operation, that would be another possibility or they could be the fact of favoring them by granting them better treatment by the fiscal agency.

So all those are arguments that could be made in hypothetical cases. Now, this would certainly be a difficult case. Well, specific, can anybody turn dollars into local currency and local currency into dollars in the same rate?

The last one, and this is possibly the most messy one of all. Can it be also considered kind of a dumping? Well, the first question is: is dumping done
at a firm level or government level? Now supposed that the exporter is selling the same product abroad and domestically. Now, this exporter would receive the same money for the same product. So, if the firm receives domestic currency for the product, it would be indifferent, arguably, for the firm, if the purchaser is in the same market or abroad.

However, if the exporter had to do his business using a different exchange rate, say an equilibrium exchange rate calculated, the firm would be receiving less domestic currency for their export. However, is dumping a behavior at the firm level or a behavior at the government level? I don't want to answer that question, but normally, it is considered at a firm level not at a government level.

So, the question is could dumping be found when an exporter is receiving equal amount regardless of where the purchaser is? Difficult. Could calculated margin exceed the actual margin of dumping received? Well, basically the same question. Of course, it could raise multi-currency practices and those can be tantamount to a subsidy or a dumping. It could be made the case.

The last Article 241 says 'that when does comparison between the export price and the normal value requires a conversion, then the investigating authority has to use the rate of exchange of the day of the sale'.

Now, it could be that there is an equilibrium exchange rate for the day. It could be made, but could it be calculated for the day, but would this construction supplant the rate of exchange of the day of the sale. Okay. This was all. Thank you so much.

Aluisio de Lima-Campos: Well, I think this was enough to demonstrate that this was not an easy question, to say the least. Since we are a little bit short of time again, I will make a short question, but not an easy one to answer but do your best job. To the panel, given all that was presented to you and there was something that Hector referred to that is key to this, in my view, from the legal point of view, is the question as to whether the WTO should consult the IMF at all in the context of a panel.

As you well put it Hector, a panel is not obligated to consult anybody and if they do, they're not obligated to take into consideration anything. What article 15 says is that contracting parties must consult, but that's a different story.

So given that, and this is the big question, in the case of a panel be it—if it is an Article 15 panel, I can't see the problem there. If we're talking about looking at a complainant that received a countervailing duty as a result of an undervaluation or better yet as a predatory currency devaluation, if a panel looks at that, would they be required to consult? Is it necessary to
consult the IMF? And would Article 15 at this point have any influence in this case? I just put it to the panel and then we’ll open for question from the public

Michael Gadba: I’ll just offer an observation. I think the language of 15(9), the [inaudible 0:01:49] begins with, “nothing in this agreement.” Now, you can argue about whether that applies only to the agreement as it existed when that provision was drafted or it encompasses the entire WTO, which was embellished over the years including booting a single undertaking. But I think that would make it very difficult for a panel in a situation in which I think, the respondent argued that 15(9) was relevant to their defense. And in that circumstance, I think it would be pretty hard for a panel to work around the language of 15(9) to say that it doesn't even have to consider the views of the IMF. I think to me that would be difficult.

Gary Hufbauer: Let me jump in on that. I agree basically with what Michael has said, but I insist that a very sharp distinction between the use of the word frustration and the use of the word manipulation. So, it certainly is a political matter the WTO should consult with the IMF, but that does not mean that the IMF determines whatever it says if it says anything, as Hector said it, it could very well be silent, that the IMF preempts a determination of frustration by the panel.

And I want to add just ad-libbing to the basic question, but I think the phrase exchange action, which Hector emphasized, includes inaction. Inaction when the market drives the exchange rates too low, it's well known that countries intervene to stabilize exchange rates and if a country decides to not intervene, I think that's exchange action.

Hector Torres: Thank you. Well, I basically agree with my two colleagues. Michael made a very good point. Michael made a very good point, the panel would be in a very awkward situation if it did not consult, considering Article 15(9). I would say that if it did not consult, I can see a case against whatever the panel comes out with on the basis of Article 11 of this dispute settlement understanding, which is the obligation of the panel to make an objective assessment of the case. I see it very unlikely that the panel would not consult and I would argue that it will consult.

Now if the panel is going to get an answer, that's another question. I believe that I wouldn't be waiting for an answer from the IMF, other than maybe repeating what the Article 4 last report may say.

And then just to bring the case, in 2007 after a lot of work, we did approve a decision on bilateral surveillance and the decision was never applied, precisely because it required a determination of fundamental misalignment. It was shelved because there was a political issue. And
Daniel was there and stayed there after I left and he can say. So that decision had to be replaced and then, it was applied. I would say I wouldn't wait for an answer.

Aluisio de Lima-Campos: All right, we'll open the questions. Come on, I'm sure there must be questions.

Sherman Robinson: Sherman Robinson from the International Food Policy Research Institute. There's something odd about trying to get the WTO, which as all of you have mentioned is a very micro focused institution to be dealing with exchange rates. Let me just hit on one.

What would be the remedy from the WTO if you did say there was an exchange rate misalignment of some kind or a willful one? The WTO works by panels commodity by commodity, but the inherent implication of an exchange rate is hitting all sectors all at once. You're going to do a general, as if you have a general tariff that you're doing. So it's going to affect all your export industries. I don't see how you could determine damage. Doing it sector by sector simply doesn't work. They don't add up. The damage to all the sectors is not the sum of the sectors analyzed one at a time. I don't see how your panels could do anything to determine damage.

Gary Hufbauer: Can I [inaudible 1:06:13] on that, Aluisio. The way Sherman has framed the question, assumes that a country such as Brazil, they could throw in the kitchen sink and bring in Article 22, 23, 15 agreement on subsidies and countervailing measures to the WTO as an authentic issue. But what Vera and Aluisio has put together is a much better approach, which is that a group countries who are offended by this undervaluation practices initiate their own respective countervailing duty cases against the offender or offenders. And then, it's up to the offender to bring a defensive case in the WTO.

The beauty of that is it's going to take three years or more; and all that time, the countervailing duties run and there's no, at least in historic WTO practice, there's no refund of countervailing duties, which were found to be properly applied, so the money is paid.

And further, if you get a number of countries going against an offender, then the offender might very well enter into the negotiations, which are outlined in what Aluisio has written in and what we've written, to have a new code of practice in this area.

So that maybe Sherman, the answer is, at the end of the day, you get a code and it's self-disciplining and in the meantime the country sees that its approaches is developing quite a bit of opposition in the world community.
and it reforms its approach. So it's not the money amount of remedy that's at stake.

Michael Gadbaw: I would add do that.

Sherman Robinson: So you're not allowed to do a countervailing duty that's in excess of the damage?

Gary Hufbauer: Who says? You get a countervailing duty. Candidate Romney said he'd do it. He didn't say exactly how, but it's not clear under the U.S. law that you couldn't apply countervailing duty against an undervalued currency. That would work its way to the U.S. Courts a couple of years already. And if the U.S. Court said you couldn’t, then it would be refunded. But the whole idea is you bring attention to the offender to change its ways. That's the dynamic of the Vera, Aluisio and colleagues approach.

Michael Gadbaw: I would just add three points. One: because the rule making system in the WTO has broken down, the rule enforcement—the dispute settlements system has taken on a more important role and I think it has responded to that and I think it could respond to that in creative ways.

Number two; a lot depends on how the case is presented. Aluisio is arguing the case would be presented, really by a respondent coming in saying, “I'm subject to countervailing duties by a whole series of countries and those countervailing duties are illegal.” Remember when in the early 70s when I joined the Treasury in '75, we were litigating over the legality of the import surcharge that Paul Volker and Company put on when we abandoned the gold standard.

It’s conceivable that countries could design a safeguard system. A special safeguard system to deal with particularly egregious cases of either manipulation or misalignment and particularly serious impacts on a sectorial or individual economic basis part of their economy. So it might be very very targeted if it would teed up that way the DSS would have to think of it in those terms.

And ultimately, there is always the possibility of a settlement. The WTO very much favors negotiated resolutions of cases and so you could conceivably see case brought that would lead to a negotiated solution, perhaps on an ad hoc basis, perhaps even on more broadly constructed basis.

Pablo Bentes: Aluisio, could I quickly interject on this debate? I think what my predecessor here and Gary--so Pablo Bentes, Steptoe & Johnson formally with the appellate body of WTO. Gary and the previous debater were slightly talking pass each other, because even countervailing duties, Gary,
under domestic level are premised on a subsidized product. So the point that the colleague here raised continues to relevant, even in a situation where you would have a concerted action by a number of countries at the domestic level, which could be potentially challenged at the WTO.

You would still have to define at that level, what is the subsidized product? And that will be the case if you're doing at the domestic level or if you're doing a serious prejudice claim under Part 3 of the SCM agreement.

So, I think the point he was raising rather, was a question of remedy. The end result of all of the WTO litigation against—assuming it's a violation for frustration Article 15 or even if you resort to a non-violation complaint, the end result is, you're going to retaliate somehow, right? And retaliation, essentially, will take form of some sort of surcharge on imports, which is something you don't even have to bother to go through litigation to do.

Article 28 of the GATT is there. So if there's political will to do so, all you have to do is show up and say, "Look, my bound tariffs are no longer reflective of what I negotiated," and that of course will trigger a wholesale renegotiation of tariffs. We've seen Ukraine doing just that recently.

So, I think you and the colleague were talking about different subjects. There’s a notion of subsidized product is one thing, remedy, which is the point here raised, is a different topic. Thank you.

Aluisio de Lima-Campos: Thank you, Pablo.

Michael Gadbaw: Could I say something about something that maybe here an assumption that I would like to challenge a bit, which is that: an undervalued currency is a subsidy to the exports. It is mostly that, but it depends very much on how integrated those exports are into world value chains.

The WTO has made a very strong case about the point on this that if the exports exporter basically processing imports and just adding to those imports, value added, mostly through local labor and that’s fraction of the cost of the imported imports, the equation is not so simple as to prove that an undervalued currency would provide a subsidy. Indeed, it would make all the imports more expensive. So of course, it depends what products are you thinking about. But bear in mind that the more integrated into an international value added change, the more difficult it will be to prove the link between supposedly or purportedly undervalued exchange rate and export subsidy.

Aluisio de Lima-Campos: Adam please.
Adam Posen: I am here to say two things. First: an enormous thank you to Aluisio, to Gary, to Hector and to Mike. It is rare that we have lawyers of such astute economic and policy wisdom and we are delighted to have assembled them. This is exactly the kind of [inaudible 01:14:34] this conversation and this institute needs. So thank you very much.

And second: my favorite statement of the day; this panel is coming to a close. Luncheon is ready on time. I would encourage everyone in an orderly non-trampling fashion, to proceed to the back of the room after thanking our speakers for the last panel.