Conference on China's Exchange Rate Policies

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The US Congress and the Chinese Yuan

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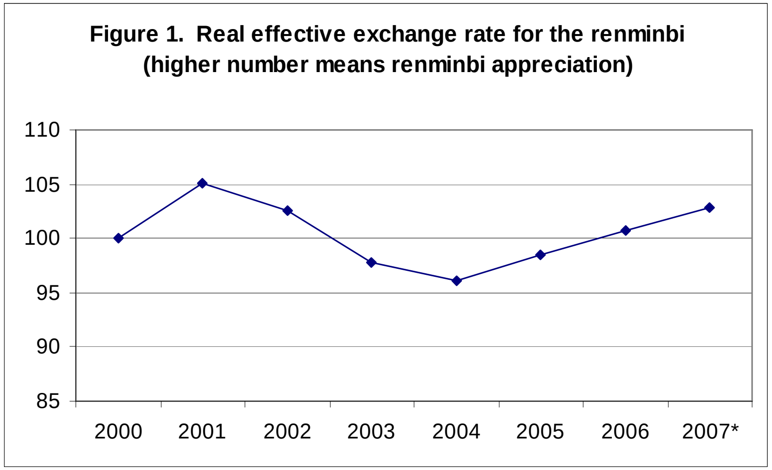
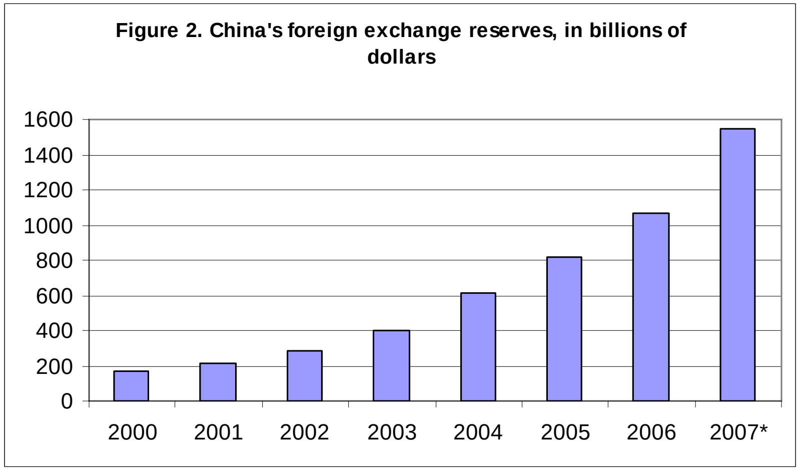
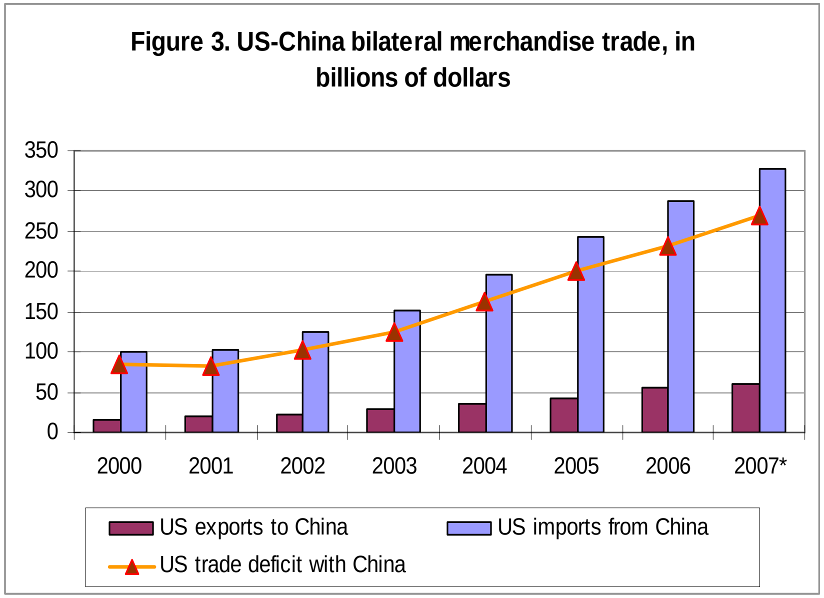
Economic Facts Driving Political Debate







Three Leading Congressional Bills – Their Moving Parts

- Bills differ in covering a narrower or wider range of currency practices—just the yuan or also the yen and others?
- All bills eliminate “intent” as factor in determining whether or not a currency is “misaligned” or “manipulated.”
- Commerce and Treasury are instructed to invoke unilateral and multilateral trade remedies if China does not revalue.
- Treasury is instructed to present a more forceful case in the IMF.
- The bills enunciate various deadlines for action, ranging up to 360 days. “Turn the screw,” not “slam the hammer.”
- Some of the bills allow a presidential waiver.

Ryan-Hunter (H.R. 2942)

- A “fundamental and actionable misalignment” exists if the amount of undervaluation has consistently exceeded 5 percent on average over the past 18 months and the foreign government has engaged in large scale intervention.
- Penalties: vote in the IMF against the offending country, oppose OPIC loans to US firms in that country, consider misalignment when reviewing NME status; count undervaluation in antidumping cases. After 360 days, initiate a WTO case and consider remedial action.

Senate Finance – Schumer-Grassley-Graham-Baucus (S.1607)

- A “misaligned” currency is to receive “priority action” if significant and sustained undervaluation is driven by explicit government policy.
- Penalties: engage in bilateral and multilateral consultations and vote in the IMF against the offending country; after 180 days, stop federal purchases of the country’s goods and services and deny OPIC loans to US firms in that country; after 360 days, initiate a WTO case and consider remedial action.
- The bill allows a presidential waiver but also allows a Congressional override.

Senate Banking – Dodd-Shelby (S.1677)

- A country is a “manipulator” if it runs large current account surpluses, bilateral trade surpluses with the US, and engages in prolonged one-way intervention.
- Penalties: bilateral and multilateral consultations and vote in the IMF against the country; after 270 days, initiate a WTO Article XV (4) case.
- The bill allows a presidential waiver.

Engaging the WTO

- **A case brought under GATT Article XV(4)** alleging that China's undervalued renminbi "frustrates the intent of the provisions of [the GATT]" confronts the division of terrain between the Fund and the WTO. The best outcome, from the US perspective, is to force IMF attention on the renminbi exchange rate.
- **A case brought under Article 3 of the Agreement on Subsidies and Countervailing Measures (ASCM)** alleging that the undervalued renminbi amounts to a "prohibited [export] subsidy" faces major obstacles: showing that a "financial contribution" is conferred upon a "specific" firm or industry.
- **US CVD and AD laws can be amended to count undervaluation as an element of subsidy or dumping**. China could contest such an amendment in the US courts and the WTO, but US imports of Chinese merchandise would decrease sharply while duties are collected. This might focus Beijing's attention on the currency question.

A Larger Voice for Congress?

- The House and Senate Finance bills would establish a new Advisory Committee on International Exchange Rate Policy with several members designated by the Senate and/or House.
- The Senate bills reflect a struggle within the Senate on immediate jurisdiction and subsequent surveillance: “manipulation,” with its emphasis on currency intervention, confers jurisdiction on the Senate Banking Committee while “misalignment,” with its emphasis on trade effects, confers some oversight on the Senate Finance Committee.
- Congressional chairs at the exchange rate table will hamper the Treasury and the Fed. But if the Congressional voice is heard only in exceptional circumstances and does not impede crisis management, the new arrangement would be hard to criticize.

Concluding remarks

- Trade penalties against China are likely to spark retaliation. Note the tit-for-tat flavor of the product safety debate.
- Congressional legislation with trade penalty measures may lead to a global cycle of protectionist legislation—if the European Union, China, and others fashion their own exchange rate remedies with trade penalties.
- One possibility is to concentrate new legislation entirely on the Treasury’s exchange rate report and IMF deliberations.
- If trade measures are used, they should be limited to situations where four tests are met: The country is a major center of commerce, it is running a large global current account surplus, its official reserves substantially exceed a prudent level, and the currency is truly “manipulated” through prolonged one-way official intervention.