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The Legal Framework of Countervailing Under WTO Laws

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ABSTRACT

Currency manipulation has been a long-discussed topic in international trade law. Back in the 1980s, one big topic in international trade was US dollar's overvaluation and Japanese yen's undervaluation, which was resolved after the Plaza Accord in 1985. [1] Around 2010, Chinese yuan's undervaluation because of currency manipulation became a huge issue in the US.

Therefore, this paper will examine whether there is a venue to take some limited measures to counter currency manipulation under current WTO rules.

Keywords: WTO, Currency, Manipulation, Countervailing.

[1] https://www.bruegel.org/2019/05/will-chinas-trade-war-with-the-us-end-like-that-of-japan-in-the-1980s/

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I. INTRODUCTION

Currency manipulation has been a crucial issue in international trade law. Back in the 1980s, one big topic in international trade was US dollar's overvaluation and Japanese yen's undervaluation, which was resolved after the Plaza Accord in 1985.[2] Around 2010, Chinese yuan's undervaluation because of currency manipulation became a huge issue in the US. Though it is said China has not been actively intervening into its foreign exchange market recently, the significance of this topic has not ceased. In 2020, the US Department of Commerce (USDOC) amended its regulations to allow using countervailing duties to offset currency manipulation as "subsidy".[3] The use of countervailing duties with regard to currency manipulation was an option that was discussed around 2010 but the US government did not take then. Now, under the new regulation, USDOC is investigating the first case to calculate currency manipulation as a countervailable subsidy.

However, it is not legally clear whether the rules of the World Trade Organization (WTO) allow such use of countervailing duty law to offset currency manipulation. Therefore, this paper examines whether there is a way to take some limited measures to counter currency manipulation under current WTO rules. Unlike most of prior scholarly analyses (which were written around 2010),[4] I do not confine my analysis only to China's currency scheme. There are three reasons to this approach; (1) China has not actively engaged in foreign exchange intervention for several years according to researches; (2) the line among (a) foreign exchange intervention under fixed or managed float currency regime, like the Chinese system, and (b) foreign exchange intervention under floating currency scheme, and (c) monetary policy measures, is not obvious, especially when we analyze them through subsidy rules' lenses; (3) USDOC's new rule does not confine its application to China (or fixed or managed float currency regime).

[2] https://www.bruegel.org/2019/05/will-chinas-trade-war-with-the-us-end-like-that-of-japan-in-the-1980s/

[3] 19 CFR 351

[4] See e.g., John, Magnus, and Timothy C. Brightbill. "China's Currency Regime Is Legitimately Challengeable as a Subsidy Under ASCM Rules." *The US-Sino Currency Dispute: New Insights from Economics, Politics and Law, Simon Everett (ed.), London: Center for Economic Policy Research* (2010): 147-155; Benjamin Blase Caryl, Is China's Currency Regime a Countervailable Subsidy - A Legal Analysis under the World Trade Organization's SCM Agreement, 45 J. World Trade 187 (2011); Daniel C. K. Chow, Can the United States Impose Trade Sanctions on China for Currency Manipulation, 16 Wash. U. GLOBAL Stud. L. REV. 295 (2017); Aluisio de Lima-Campos & Juan Antonio Gaviria, Case for Misaligned Currencies as Countervailable Subsidies, A, 46 J. World Trade 1017 (2012). Though the last one argues that its analysis applies to cases other than China, it seems to assume a regime of managed float like China before 2014.

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Though some of the prior studies about currency manipulation have denied the existence of subsidy based on macroeconomic analyses, [5] international trade rules are not necessarily consistent with economic rationality. Therefore, this paper does not go into whether such legal analyses make a macro-economic sense. This paper rather examines these approaches mainly by analyzing legal limitations posed by WTO treaty language and past jurisprudence.

The first half of the paper examine the WTO rules regarding subsidy, which include Article VI and Article XVI of General Agreement on Tariffs and Trade (GATT), SCM Agreement (ACSM), and the China Accession Protocol. The second half examines possible options, other than utilizing subsidy rules, to counter currency manipulation under WTO law. It includes bringing a WTO dispute settlement action against currency manipulating countries for violation of GATT Article XV, which provides rules for exchange rate actions. Another approach other than subsidy is to sue currency manipulating countries under the non-violation nullification or impairment clause of XXIII 1. (b).

II. BACKGROUND - CATEGORIES OF INTERVENTION MEASURES

A. Legal issues

Under ASCM, to be a countervailable subsidy, a measure must satisfy three requirements: (1) financial contribution (or price support), (2) benefit, (3) specificity. To analyze whether a currency-related measure satisfies the first two elements, it is dispositive what kind of intervention measure a country took to influence exchange rates. It is because whether and how money flows from the government to the end user of foreign exchange – companies that export goods in particular – differs greatly dependent on the type of measures influencing exchange rates. The third element – specificity – does not much depend on the types of intervention measures.

In this section, I first introduce typical methods of measures the governments commonly use that, at least potentially, influence the exchange rates. Then, I examine each element of subsidy; financial contribution and benefit first, and specificity last.

(The analysis in this section basically applies to both CVD investigation and the WTO DS procedure under Article 4. However, I assume the situation of CVD investigation for the sake of simplicity of arguments. I omit injury analysis for CVD investigation because the injury part is same as other ordinary CVD investigations.)

B. Categories of policy measures to influence exchange rates

There are various channels to influence exchange rates, and various instruments exist for each channel. In addition, the meaning of such measure differs, in terms of financial contribution and benefit analysis, based on a country's exchange rate system: fixed, managed float, or floating exchange rate. I will explain the relevant (1)

[5] See, e.g., Staiger, Robert W., and Alan O. Sykes. "'Currency manipulation'and world trade." *World Trade Review* 9.4 (2010): 583-627.

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channel, (2) instrument – especially with regard to the "portfolio balance" channel, and (3) exchange rate system, in turn.

According to a comprehensive study by the Bank for International Settlements (BIS), there are four main channels to influence currency exchange rates. The first is the **monetary policy** channel.[6] The difference between the interest rate on the domestic currency and those on foreign currencies influences exchange rates. Thus, a country can influence exchange rates, intentionally or unintentionally, by changing its domestic exchange rate.[7] Quantitative easing, which many countries now implement, is a variation of this channel because it affects interest rates. However, it can be different from the subsidy's perspective, because quantitative easing involves massive purchases of assets (usually government bonds, but can include corporate bonds and other financial assets) by the government.

The second channel is **portfolio balance**. A government can influence exchange rates by changing relative scarcity of domestic versus foreign currency assets[8]; for example, by selling domestic currency and buying foreign currencies in a foreign exchange market. This is probably a typical “currency intervention” method many people imagine. The third is **the signaling** or **expectations** channel. This includes a signaling comment by the central bank, for example about the future direction of its monetary policy, that changes perceptions of market participants. Such a change in perceptions can result in currency rate change without any foreign exchange transaction taken by the government. The fourth is the **order flow** channel. This channel is similar to the portfolio balance channel, in the subsidy context, because it usually involves purchases of currency assets by the government. It is different from the portfolio balance channel in that it does not mainly influence trading volume and asset scarcity, but influences market participants' behavior, by altering order flow patterns in a foreign exchange market by putting their own orders secretly.[9] Intervention in this channel might require less amount of money compared to the portfolio balance channel.

For the purpose of this paper, the signaling or expectation channel is less important because it does not, in itself, involve any transfer of money by the governments. Portfolio balance and order flow channels can be treated similarly because the type of transaction the governments make is basically the same between those two. Therefore, I will then look closer into specific instruments the governments use in making transactions for these two intervention channels.

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[6] David Archer, at 41

[7] Though what theoretically matters is a change in the real interest resulted from an interest rate manipulation by a country, this paper does not distinguish these two because it does not matter a lot in subsidy analysis.

[8] David Archer, at 41-42

[9] David Archer, at 42. Secrecy is not a strict prerequisite of this channel, but it might increase the effectiveness of an intervention.

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According to the BIS study in 2005, the most common instrument for intervention is **spot** transaction in onshore (and wholesale) foreign exchange market.[10] Another study shows that about 80% of intervention, by emerging economy governments, occurs in the spot market.[11] Spot transaction is a basic type of currency transaction where market participants exchange (deliver) currencies at the present time (or within a few days).[12] **Future** and other **derivative** instruments (such as swap and option) are less preferred as a means to intervene in the foreign exchange market.[13] These instruments other than spot does not usually involve immediate transfer of currency. For example, future contracts promise the delivery of currency at a specified future price, on a certain future date.[14]

On top of these various channels and instruments, a specific currency exchange rate system a country maintain determines the interface between the government and ordinary customers of foreign exchange service. When it comes to floating exchange rate system, usually the government does not involve in the implementation of foreign exchange services. Ordinary customers (individuals and corporations) exchange currencies at a bank or nonbank, at a price such a financial institution determines. I call this transaction between financial institutions and end customers the "retail layer" of currency exchange service. Behind such retail transactions, foreign currency market participants (usually banks and nonbanks) make market transactions, and the market determines the market exchange rate. I call this transaction among market participants the "wholesale layer" of currency exchange service. Sometimes governments intervene in this wholesale layer by buying and selling currencies there, through the portfolio balance or order flow channel. Or they might influence the wholesale layer's behavior indirectly through monetary policy or signaling or expectation channel.

On the other hand, when it comes to a fixed exchange rate system, the government typically controls both the retail and wholesale layers. A bank can only offer foreign exchange services at the retail layer at a fixed rate determined by government regulations.[15] The government also controls the wholesale layer by directly regulating the exchange rate at the market or selling and buying currencies at a fixed price indefinitely.[16] The government usually combines the monetary policy channel to keep

[10] BIS, 2005, at 44 and 48
[11] IMF, 2003
[12] https://www.kbrfx.com/terms/definition/spot-transaction
[13] BIS, 2005, at 44
[14] https://www.kbrfx.com/terms/definition/Futures
[15] Hong Kong’s case (cite)
[16] Hong Kong’s case. https://www.mizuho-ri.co.jp/publication/research/pdf/asia-insight/asia-insight050819.pdf

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the price at the wholesale layer fixed, when it allows free capital flow.[17] Hong Kong dollar is a typical example of such a fixed exchange rate system.[18] China before 2005 was an example where the government controls the wholesale layer by strictly regulating capital flow (and selling and buying currencies there).

Managed float regime comes in between. Vietnam is a good example of managed float. The Vietnamese government regulates the exchange rate a financial institution can offer at the both customer and wholesale layer. However, a financial institution has leeway, and it can determine the exchange price within +/- 3 percent of the rate determined by the Vietnamese central bank.[19] China, before 2014, had basically the same system.[20] In contrast, current China's system allows free price setting at the retail layer.[21] It only regulates the exchange rate at the wholesale layer.[22] There, financial institutions can buy and sell currencies at a price within +/- 2 percent of the rate determined every morning by the exchange market operator (which is 100% owned by the Chinese government). Chinese central bank may also intervene in the wholesale rate by selling and buying currencies there.

III. DISCUSSION BASED ON EACH COMPONENT OF SUBSIDY REQUIREMENTS AND CATEGORIES OF INTERVENTION MEASURES

A. Financial contribution or price support

ASCM Article 1.1 (a) lists categories of financial contribution (and price support). According to an established Appellate Body precedent, this is an exhaustive list.[23] In addition, the negotiation history of ASCM tells that not all government measures that confer benefits to recipients could be deemed to be subsidies.[24] As currency manipulation is not specifically mentioned in the list, we first need to identify whether a currency-related measure can be interpreted to fall in either one of the four categories of financial contribution, or in the definition of price support.

i. ASCM Art.1.1 (a)(1)(ii) and (a) (2)

Among them, "government revenue that is otherwise due is foregone or not collected" (Article 1.1 (a)(1)(ii)) and "income or price support" (Article 1.1 (a) (2)) are unlikely fit in measures of currency manipulation. As for Article 1.1 (a)(1)(ii), the Appellate

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[17] E.g., Hong Kong. https://www.mizuho-ri.co.jp/publication/research/pdf/asia-insight/asia-insight050819.pdf

[18] https://www.mizuho-ri.co.jp/publication/research/pdf/asia-insight/asia-insight050819.pdf

[19] USDOC, Preliminary Decision Memorandum, case C-552-829, at 21

[20] See John, Magnus, and Timothy C. Brightbill, p.1

[21] https://www.jetro.go.jp/world/asia/cn/trade_04.html

[22] https://www.jetro.go.jp/world/asia/cn/trade_04.html

[23] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 614

[24] Panel Report, *US – Exports Restraints*, paras. 8.65 and 8.73.

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Body in US – FSC stated that “a comparison must be made between the revenue actually raised and the revenue that would have been raised "otherwise"”[25] Many understand that this clause is satisfied only when private entities owe the government money, tax, or debts and the government foregoes it.[26] In the currency exchange context, private entities owe no money prior to the exchange, and thus revenue foregone is unlikely to be satisfied. Of course, it is not completely impossible to interpret that the clause covers currency manipulation; for example, some might argue that when the government sold the currency at a below-market rate, it could be seen to lose the revenue that would have been raised if it sold at the market rate. However, such interpretation is much weaker than arguments under other clauses.
Article 1.1 (a)(2) is slightly better than (a)(1)(ii), but it does not generate a strong argument either. Article 1.1 (a)(2) provides as a type of financial contribution "any form of income or price support in the sense of Article XVI of GATT 1994". Article XVI of GATT 1994 does not provide a direct definition of income or price support. It only provides that "income or price support" is included in the definition of the regulated subsidy, which is a subsidy "which operates directly or indirectly to increase exports of any product from, or reduce imports of any product into [a WTO Member's] territory". There is no WTO jurisprudence that interpreted ASCM Article 1.1 (a)(2) or GATT Article XVI. It could be argued that currency manipulation (or more precisely, currency undervaluation) is "price support" because the government is supporting the price of foreign currencies.[27] However, in the context of the Agreement on Agriculture, the Appellate Body has stated that “income or price support” exists when a government commits to buy domestic agricultural products at a high set price regardless of world market price.[28] To analogize this holding to the context of ASCM, it is natural to interpret that the target of “income or price support” has to be the products covered in the agreement, i.e., goods in the context of ASCM that only covers trade in goods. Therefore, though no dispositive interpretation exists, there is not a strong argument to cover currency price support by this clause.[29] (P)[30]

[25] Appellate Body Report, *US – FSC*, para. 90.
[26] Daniel C. K. Chow, Can the United States Impose Trade Sanctions on China for Currency Manipulation, 16 Wash. U. GLOBAL Stud. L. REV. 295 (2017). But no source is cited for this assertion.
[27] Aluisio de Lima-Campos & Juan Antonio Gaviria, at 1028
[28] Appellate Body Report, *EC – Customs Classification of Certain Computer Equipment*
[29] Though reasoning is not clear, proponents of “currency manipulation as a subsidy” take the same view that this clause is unlikely to support the existence of currency manipulation subsidy. *See* e.g., Benjamin Blase Caryl
[30] China GOES? Look at Peter Van den Bossche, at 1156.

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ii. ASCM Article 1.1 (a)(1)(i) and (iii): direct transfer of funds and government provision of services

Among four types of financial contribution, "(potential) direct transfer of funds" (Article 1.1 (a)(1)(i)) and "provision of services" (Article 1.1 (a)(1)(iii)) are most promising to cover currency manipulation. Appellate Body defines "direct transfer of funds" as "conduct on the part of the government by which money, financial resources, and/or financial claims are made available to a recipient"[31] [32] This is a broad definition that covers more than what Article 1.1 (a)(1)(i) provides as examples of direct transfer of funds: namely, grants, loans, and equity infusion. Article 1.1 (a)(1)(iii) provides that there is a financial contribution where "a government provides goods or services other than general infrastructure, or purchase of goods". Though a panel interpreted that "money" is not included in "goods" in the context of Article 1.1 (a)(1)(iii),[33] no panel or Appellate Body has defined "service".

1) Spot intervention under portfolio balance channel

The categorization of foreign exchange rate intervention measures supports our analyses here. Some measures clearly fit the definition of either of them, and others are grey or unlikely fall in the definition. A type of measure on the side of clearly falling in the financial contribution is where a government agency exchanges currency on spot transactions, i.e., where the government provides domestic currency to a private entity in return for foreign currency. In this case, what is done by the government is the same as what private banks do when the government does not intervene in the foreign exchange. Such foreign exchange services can safely be categorized as one of the many financial services. Therefore, we can interpret that a spot intervention measure is a sort of government provision of services. It can also fall into the definition of direct transfer of funds. Spot currency exchange is a government's conduct by which "money" is made available to a recipient (= transaction partner(s) in that exchange). [34] Actually, when it comes to financial services, many of them are also included in Article 1.1 (a)(1)(i), such as loans or equity infusion. Therefore, it is natural that both are possible.

What is worth noting here is that the above is a case where the government directly make currency transactions with a private entity, and such entity is likely a financial institution (at the wholesale layer) in many cases. If such a financial institution provides currency exchange service to export companies (at the retail layer), this transaction does not in itself constitute a direct transfer of funds or government's provision of service. To determine whether such private transactions can be calculated

[31] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 614.

[32] Cf. "'funds' in Article 1.1(a)(1)(i) encompasses not only 'money' but also financial resources and other financial claims more generally.", debt-to-equity swaps and debt-forgiveness are included

[33] Panel Report, *US – Softwood Lumber III*, para 7.22-7.23.

[34] See Staiger, Robert W., and Alan O. Sykes, at 610

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in a subsidy investigation, we need to make a pass-through analysis, which is examined in the benefit part later. Alternatively, if such a financial institution is a public body or it is "entrusted or directed", by the government, to provide foreign exchange at a certain exchange rate, such a transaction at the retail layer can directly be a financial contribution, under the chapeau of Article 1.1 (a)(1) or Article 1.1 (a)(1)(iv). This public body and entrustment analysis is also made later.

2) Signaling or expectation channel

Let's return to the categorization of foreign exchange rate intervention measures and financial contributions. A type of measure on the side where it is difficult to find financial contribution is signaling or expectation channel. Intervention via signaling or expectation channel does not involve transfer of money, financial resources, or financial claims from the government to a private entity. Mere information about future exchange rate policy or monetary policy is transmitted from the government to market participants. It is difficult to categorize such public communication as (financial) "service". It does not fall in the definition of direct transfer of funds either.

3) Monetary policy channel

Measures via the monetary policy channel are in a grey area. When the government (or central bank) alters the public interest rate, which in turn might influence exchange rates, it usually involves financial transactions with banks, such as short-term lending by the central bank at a certain interest rate. [35] [36] Such transactions are, if captured separately, likely to fall into the definition of direct transfer of funds. Alternatively, such financial transactions might fall in the definition of provision of (financial) services. However, the relationship between such monetary policy intervention and undervaluation of domestic currency (= benefit) is quite indirect. Monetary policy measures, such as changing the interest rate of short term central-bank lending, influence interest rates (and inflation rates), and the change in interest rates (and inflation rates) might influence exchange rates. Though such indirectness can be addressed in the benefit analysis, this level of indirectness poses a question on the existence of financial contribution in the context of exchange rate manipulation.

The same analysis applies to quantitative easing, but it might be slightly more difficult to categorize as a financial contribution. Quantitative easing involves the central bank's large-scale purchases of financial assets, such as government bonds, from banks. It would therefore fall better in the definition of "purchases of goods" in Article 1.1 (a)(1)(iii) than a direct transfer of funds. Here, whether the definition of goods includes intangible financial assets can be an issue, in connection with the fact that "purchase of service" is excluded from the definition of financial contribution.

[35] https://www.imf.org/external/pubs/ft/fandd/basics/monpol.htm

[36] https://www.federalreserveeducation.org/about-the-fed/structure-and-functions/monetary-policy

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Therefore, it could be argued that purchases of financial assets are purchases of (financial) services and thus excluded from financial contribution. However, such interpretation is inappropriate and unlikely to be adopted by a WTO panel, because it creates a huge loophole in subsidy rules. Thus, quantitative easing is as likely to fall in Article 1.1 (a)(1) (i) or (iii) as other monetary policy measures.

iii. ASCM Article 1.1 (a)(1) chapeau ("public body") and (a)(1)(iv) (government entrustment or direction)

In the preceding subsection analysis, I basically assumed that government interventions are made at the wholesale level, not at the retail level where private (or public) financial institutions make transactions with individual export companies. By using ASCM Article1.1 (a)(1) chapeau ("public body") and (a)(1)(iv), analysis at the wholesale level could be extended to the retail level.

1) Public body

Article1.1 (a)(1) provides that there must be "a financial contribution by a government or any public body". The article treats a "public body" the same as the government like the central bank. Therefore, if a private (non-government) financial institution is a public body, currency exchange transactions it makes at the retail level are likely financial contributions to their individual customers (i.e., an analysis same as the one about the spot intervention applies).

The Appellate Body in US – Anti-Dumping and Countervailing Duties (China) held that a public body "must be an entity that possesses, exercises or is vested with governmental authority".[37] As "the precise contours and characteristics of a public body are bound to differ from … case to case",[38] it is impossible to a public body analysis apart from a concrete case. However, it might be worth noting that the Appellate Body has found that Chinese state-owned commercial banks are public bodies, in the context of provision of loans.[39] Since the focus of the public body analysis is "on the entity ..., its core characteristics, and its relationship with government"[40], the same state-owned commercial banks are likely found to be public bodies in the context of currency exchange services (until Chinese laws other facts that vested them with governmental authority change). UCDOC, in the ongoing currency manipulation case, has preliminary found Vietnamese state-owned banks are vested with governmental authority and thus public body, in light of their ownership structures and the Vietnamese government's other abilities to control their decisions.[41]

[37] Appellate Body Report, US – Anti-Dumping and Countervailing Duties (China), paras. 317-318.
[38] Appellate Body Report, US – Anti-Dumping and Countervailing Duties (China), paras. 317-318.
[39] Appellate Body Report, US – Anti-Dumping and Countervailing Duties (China), para 356
[40] Appellate Body Report, US – Countervailing Measures (China) (Article 21.5 – China), para. 5.100.
[41] USDOC, Preliminary Decision Memorandum, case C-552-829

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2) Government entrustment or direction

Article1.1 (a)(1)(iv) provides that financial contribution exists where a "government … entrusts or directs a private body to carry out one or more of the type of functions" illustrated in subparagraphs (i)-(iii). Therefore, if a private financial institution is "entrusted or directed" by the government, currency exchange transactions it makes with individual customers are likely financial contribution; namely, direct transfer of funds (subparagraph (i)) or provision of services (subparagraph (iii)).

According to the appellate Body in US – Countervailing Duty Investigation on DRAMs, "'entrustment' occurs where a government gives responsibility to a private body, and 'direction' refers to situations where the government exercises its authority over a private body". In either case, the government "uses a private body as a proxy to effectuate" financial contributions listed in subparagraphs (i)-(iii). Though entrustment or direction is also difficult to analyze in the abstract, "[i]n most cases, one would expect entrustment or direction of a private body to involve some form of threat or inducement".[42] Therefore, if financial institutions are required, by regulations, to make currency exchange at a certain rate, such regulations likely satisfy the requirement of entrustment or direction. As explained in section II-b above, under a fixed exchange rate regime, it is typical that the government makes such regulations to control the exchange rate at the retail level.

On the other hand, it would be difficult to find entrustment or direction in a floating exchange rate country where the government does not regulate retail or wholesale exchange rates. The Appellate Body in US – Countervailing Duty Investigation on DRAMs noted that ASCM reflects a "delicate balance between the Members that sought to impose more discipline on the use of subsidies and those that sought to impose more discipline on the application of countervailing measures" and that this balance must be born in mind in interpreting Article 1.1 (1)(a)(iv).[43] When a government intervenes via signaling or expectation channel, it surely communicates their future prospects about their currency policies, but it does not necessarily threatening or inducing financial institutions to offer a certain exchange rate at the retail level. The spot intervention is not so different from signaling in that it does not induce financial institutions' actions in relation to retail customers. Influence via monetary policy channel is even less likely to be entrustment or direction, since it is aimed at monetary policy goals such as interest rate and inflation.

B. Benefit

iv. Basic concepts

Benefit is the second element that a measure must satisfy to be a subsidy. Benefit exists when a financial contribution "makes the recipient 'better off' than it would

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[42] Appellate Body Report, *US – Countervailing Duty Investigation on DRAMs*, para. 116.

[43] Appellate Body Report, *US – Countervailing Duty Investigation on DRAMs*, para. 115. *double check the source of latter half

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otherwise have been, absent that contribution."[44] The basis of determination is "whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[45] Benefit is one of the most difficult elements to analyze in the currency manipulation context, because there is usually no outside, independent currencies market other than the one influenced by the government. Though ASCM provides rules for analyzing benefit under distorted markets, in the currency manipulation context, the relationship between financial contribution and market distortion varies a lot from one intervention measure to another. Therefore, in this section, I first examine intervention types that lead to the simplest benefit analyses: the case of a fixed exchange rate regime where the government regulates both wholesale and retail. Then, I turn to more difficult cases of floating exchange rate and managed float regimes.

v. CASE OF FIXED EXCHANGE RATE WHERE THE GOVERNMENT REGULATES BOTH WHOLESALE AND RETAIL

Here I analyze a case where the government orders financial institutions to sell and buy currencies at a fixed exchange rate, both at the wholesale and retail layer. In this scenario, financial contribution exists. When we look at the retail layer, the government clearly entrusted or directed financial institutions to make financial contributions (direct transfer of funds or provision of services) to their customers, such as export companies that need to sell foreign currencies and buy domestic currencies. Benefit exists if the regulated price of the domestic currency is more favorable to customers than the market price that would have existed absent such a regulation.

In relation to this point, ASCM Article 14 provides guidelines for calculating benefit for each type of financial contributions. Article 14 (d) is the calculating rule concerning provision of services. It provides that the provision of services shall not be considered as conferring a benefit "unless the provision is made for less than adequate remuneration" and that "[t]he adequacy of remuneration shall be determined in relation to prevailing market conditions" for the services in the country of provision.[46] When prices in the country are distorted by the government predominance in the market, according to Appellate Body in US – Anti-Dumping and Countervailing Duties (China), the investigating authority may use a benchmark price based on out-of-country price.[47] (It is worth noting that the Appellate Body has also stated that such out-of-country price must be adjusted so that it properly represent "prevailing market

[44] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, para. 157.
[45] Appellate Body Report, *Canada – Aircraft*, para. 157
[46] ASCM Article 14 (d)
[47] Appellate Body Report, *US – Anti-Dumping and Countervailing Duties (China)*, para. 4.156.

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conditions" in the country.) It means that the benchmark price can be constructed apart from the facial market price in the country.

In the case where a government fixes both retail and wholesale exchange rates, there is no non-distorted market price in the country because the government completely controls the market. There is also usually no reliable, independent out-of-country market of the currency.[48] In such a case, it is likely that the investigating authority may use an alternative benchmark price based on the calculated equilibrium exchange rate that would have existed absent the fixed exchange rate regime operated by the government. Thus, if the fixed exchange rate is more favorable to exporters that convert foreign currencies to domestic currencies than such an equilibrium exchange rate, an investigating authority likely finds benefit. In such a case, the amount of benefit is calculated based on the difference between the amount of domestic currencies exporters actually received and the amount they should have received under the equilibrium exchange rate.

(Remaining Q: How about, even absent price-fixing regulation, the wholesale rate is heavily influenced by monetary policy and not as low as equilibrium value?)

Proposing the exact formula to calculate an equilibrium exchange rate is beyond the scope of this paper. However, GATT Article XV provides that "[WTO Members] shall accept all findings or statistical and other facts presented by the [International Monetary] Fund relating to foreign exchange, monetary reserves and balances of payments". Though GATT and ASCM are independent agreements, they are linked through GATT Article VI and XVI.[49] Therefore, it is appropriate to let the IMF identify the method to calculate such equilibrium exchange rates. (Note that the new regulation for US CVD investigation requires USDOC to use equilibrium exchange rates provided by Secretary of Treasury.[50])

vi. CASE OF FLOATING EXCHANGE RATE

Benefit analysis in a country with a floating exchange rate system (and with no regulations that control selling or buying rate) needs to involve pass-through analysis. It is because, in this case, the government makes financial contributions to banks, not to export companies that are the target of countervailing duties. (Note that I base my analysis on the previous conclusion that entrustment or direction is unlikely found in floating exchange rate.) As subsidies for services are not prohibited strictly,[51] we need to find a link between financial contributions to banks and benefit for export companies through pass-through analysis.

[48] Chinese RMB has an offshore Hong-Kong market.
[49] Cite AB
[50] 19 CFR 351.528(c).
[51] See GATS

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The Appellate Body in US – Softwood Lumber IV explains the concept of the pass-through well.

Where a subsidy is conferred on input products, and the countervailing duty is imposed on processed products, the initial recipient of the subsidy and the producer of eventually countervailed product, may not the same. In such a case, there is a direct recipient of the benefit – the producer of the input product. When the input is subsequently processed, the producer of the processed product is an indirect recipient of the benefit – provided it can be established that the benefit flowing from the input subsidy is passed through, at least in part, to the processed product.[52]

In our scenario, banks and export companies, which are usually not related companies, make currency exchange transactions at arm's length. In such arm's length transaction cases, "the pass-through of input subsidy benefits from the direct recipients to the indirect recipients downstream cannot simply be presumed; it must be established by the investigating authority".[53]

There are two legal and practical obstacles related to this arm's length pass-through analysis. The first is that it is not certain whether a pass-through analysis is permitted for subsidized services.[54] As in US – Softwood Lumber IV, cases involving pass-through have been on the relationship between subsidized input "products" and processed products.[55] Between input products and processed products, their physical relationship is clear. Therefore, if input was sold to the producer of processed products at a cheaper-than-usual price because of subsidies to the input, we can assume the effect of cheaper input would be transferred to the processed products. In comparison, the relationship between input "services" to a producer of processed products and processed products is more indirect. In addition, subsidies to services are not in itself strictly prohibited under WTO legal framework. The second obstacle is that it is practically difficult to establish that benefit is passed through to another entity. It would be usual that government intervention at the wholesale layer and retail transactions to export companies are temporarily distant. Furthermore, in the case of the monetary policy channel, completing a pass-through analysis is practically impossible. For example, it is impossible to establish that a financial institution has spent money it got from selling bonds to the central bank (because of quantitative easing), to lower the exchange rate it applied to an exporting company. Therefore, it is unlikely (though it might not be completely impossible) that an investigating authority to establish the existence of pass-through. (P)

On top of such pass-through analysis, an investigating authority needs to find the existence of benefit at the wholesale layer (=between the government and banks),

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[52] Appellate Body Report, *US – Softwood Lumber IV*, para. 143.
[53] Appellate Body Report, *US – Softwood Lumber IV*, para. 143.
[54] China GOES? Panel did not reject MOFCOM's "subsidies to electricity" argument?
[55]

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since otherwise there can be no pass-through from banks to export companies. It means that government intervention measures, i.e., a spot intervention in foreign exchange market (or other portfolio balance measures) or monetary policy measure, conferred benefit to banks. When it comes to spot intervention in the foreign exchange market, what central banks do is just buying a lot of foreign currencies (and selling domestic currencies in return) at the market rate at that time (or something very closer to it). In other words, central banks get adequate remuneration from banks in the form of foreign currencies. Currency price drops just as a result of the changed balance of supply and demand at the market. Monetary policy measures are similar. When it comes to quantitative easing, central banks usually buy bonds and other assets from banks via auction.

In conclusion, in the case of a floating exchange rate country without regulations to control exchange rates, benefit is unlikely found.

vii. CASE OF MANAGED FLOAT SYSTEM WHERE THE GOVERNMENT REGULATES BOTH WHOLESALE AND RETAIL

When exchange rates are regulated at both the wholesale and retail layers, the necessary analysis is similar to the fixed exchange rate case. Entrustment or direction would be found. And as a result, benefit would usually be found. However, a difference from the fixed-exchange-rate case is that banks have certain leeway to set their own price. Therefore, the amount of benefit might be different. The investigating authority needs to eliminate the effect of the own initiatives of (1) banks at the retail layer and (2) market participants at the wholesale layer. If the wholesale and retail price is at the bottom of the permitted range, it would be easier to find that the whole difference between the retail price and the equilibrium price is the result of financial contribution and thus benefit.

It might be worth noting that USDOC in the Vietnamese case is exactly the case of a managed float system where the government regulates both wholesale and retail. However, USDOC in the preliminary decision does not distinguish the effect of government regulation and the partial market force (made possible through the partial leeway to decide exchange rates banks offer). In that sense, the analysis of USDOC should be perceived as incomplete.

(Remaining Q: How about, even absent regulation to fix price range, the wholesale rate is heavily influenced by monetary policy and not as low as equilibrium value? – depend on the method to calculate the equilibrium rate?)

viii. CASE OF MANAGED FLOAT SYSTEM WHERE THE GOVERNMENT REGULATES ONLY WHOLESALE

This is another case of a managed float regime but where the government regulates only wholesale and thus banks are free to set any price at the retail layer. It is basically the same as China's exchange rate controlling system after 2014. This case

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requires the combination of the analysis of the above case and the analysis of a floating exchange rate regime.

Here, as for benefit at the wholesale layer, the analysis can be easier than floating exchange. As the price setting at the wholesale layer is controlled by the government, we can construct that banks are entrusted or directed by the government to make financial contributions (direct transfer of funds or provision of services) to other banks at the wholesale layer. The price-setting there is different from a market-without-regulation price, so an investigation authority can find the difference as benefit conferred from banks (=entrusted or directed entity) to other banks (=the initial recipient of benefit).

However, as there is no regulation as to the retail layer, an investigating authority needs to make an affirmative pass-through finding, which is difficult. No regulation at the retail layer means that investigating authority cannot find entrustment or direction that establishes financial contribution to the export companies, since the retail layer is just same as the floating exchange rate system. Thus, it needs to make a pass-through analysis to find benefit conferred to export companies. Just same as the discussion in the floating exchange case, an affirmative finding would be difficult. (P) However, it is worth noting that in a managed float system where a government has more influence on the exchange rate market participants, it might be more likely that an investigating authority finds entrustment or direction through measures other than outright regulations.

C. Specificity

Specificity is the last element necessary to find a countervailable subsidy. There are two ways to establish specificity in the currency manipulation context. The first one is the normal specificity analysis under ASCM Article 2, and the second one is the export subsidy.

ix. NORMAL SPECIFICITY ANALYSIS

ASCM Article 2.1(c) explains that measures that de facto limit access to subsidies to a specific group of enterprises could be considered a specific subsidy. In order to determine whether such a measure is de facto specific, Article 2.1(c) provides that investigating authorities may consider “other factors” such as: “use of a subsidy program by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised in the granting authority in the decision to grant a subsidy”.

The factors of "predominant users of the subsidy program" and "a disproportionately large amount receipt of the subsidy by to certain enterprises" are important in our context. If an investigation authority defines the target group of enterprises as "enterprises that export goods", it is likely that a large amount of benefit of undervaluation goes to such enterprises. For example, in EC – DRAMS, the panel

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found de facto specificity when subsidy was utilized by only six of more than 200 eligible companies, and one particular enterprise used up to 41% of the funds. A prior study states that at least 70% of the currency exchanges from dollar to RMB in China were made for exporting.[56]

A more difficult issue is whether such a broad group of enterprises ("enterprises that export goods") can be deemed de facto specific under Article 2.1(c). However, the Appellate Body has found a substantially large group as specific. For example, though it is a case of regional specificity, the Appellate Body in US – Washers from Korea upheld the investigating authority's finding that tax credit for business assets outside the "Seoul overcrowding area" was specific. In this case, the area outside the "Seoul overcrowding area" represented 98% of the geographic territory of Korea. Though Seoul is a significant center of the Korean industry, probably companies outside Seoul represent the majority of Korean enterprises. Comparing to this finding, “enterprises that export goods” is not too broad to be specific.

x. EXPORT SUBSIDY

ACSM Article 2.3 provides that export subsidy is deemed to be specific. The definition of export subsidy is “subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I”.

First of all, no usual currency manipulation scheme, as categorized in II-b, is contingent on export performance in law. Even in the case of fixed exchange rate, there is likely no requirement that the end user of foreign currency exchange services must be persons exporting goods.[57]

However, it is still possible that currency manipulation scheme is de facto export contingent. A subsidy is de facto export contingent when the subsidy is “in fact tied to actual or anticipated exportation or export earnings”.[58] The Appellate Body has elaborated the standard to find de facto subsidies. As an overall structure, it has identified three elements to find de facto export subsidy: (1) the “granting of a subsidy”, (2) that is “tied to” or “contingent upon”, and (3) “actual or anticipated exportation or export earnings”.[59] Regarding element (2), it has found that “the ordinary meaning of 'tied to' confirms the linkage of 'contingency' with 'conditionality' in Article 3.1(a).”[60] In other words, “tied to” is equivalent to a relationship of

[56] John, Magnus, and Timothy C. Brightbill.
[57] As an argument for the different conclusion, Benjamin Blasé Caryl, at 209. Though the author himself admits its weakness.
[58] ASCM Note 4.
[59] Appellate Body Report, *Canada – Aircraft*
[60] Appellate Body Report, *Canada – Aircraft*, para. 171.

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conditionality between the grant of a subsidy and export performance.[61] On its face, it is not easy to find that the receipt of undervaluation subsidy is conditioned on export performance, since the receipt of (undervalued) domestic currency is independent of the type of transaction for which the exchange is made.

However, the Appellate Body has further made other guidelines as for de facto contingency. It has provided three factors to be examined: "(i) the design and structure of the measure granting the subsidy; (ii) the modalities of operation set out in such a measure; and (iii) the relevant factual circumstances surrounding the granting of the subsidy that provide the context for understanding the measure's design, structure, and modalities of operation."[62] In addition, it has admitted that a subsidy's effect of altering the ratio between products going to export and to the domestic sales can be a basis of the contingency analysis.[63]

In the case of currency manipulation, it is likely that an investigating authority finds that currency undervaluation provides an incentive to skew anticipated sales towards exports. Such finding would be a positive factor in the context of factor (iii). It is also possible, though depends on the facts, to find that more than majority of the use of currency exchange for domestic currency is the conversion of export profits. Through such lenses, it could be possible to find that the design and structure of the measure and the modalities of operation are actually made to encourage export by subsidizing them. (P)

C.f., The argument based on Appellate Body Report of US – FSC (Article 21.5 – EC) is as applied to de jure contingency. (P)

IV. CONCLUSION

According to the above analysis, currency manipulation is countervailable under ASCM (provided that it can be calculated) if (1) currency manipulation is operated in a fixed exchange rate or managed float regime that regulates the permissible exchange rate at both wholesale and retail levels and (2) currency exchanges at retail level results in being disproportionally used to convert export profits to domestic currency,

[61] Panel Report, Australia – Automotive Leather II, para. 9.55. *See also* WTO Analytical Index

[62] Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1046.

[63] Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1047. "the assessment could be based on a comparison between, on the one hand, the ratio of anticipated export and domestic sales of the subsidized product that would come about in consequence of the granting of the subsidy, and, on the other hand, the situation in the absence of the subsidy." "Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation"

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instead of inward investments or tourist purposes. Condition (1) supports the existence of entrustment or direction, and thus currency exchange services by banks result in financial contributions to the benefit of exporters that use such services. Condition (2) ensures that such a subsidy is specific to a group of enterprises of "enterprises that export goods".

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24. Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 614.
25. Cf. “'funds' in Article 1.1(a)(1)(i) encompasses not only 'money' but also financial resources and other financial claims more generally.”, debt-to-equity swaps and debt-forgiveness are included
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