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Currency Manipulation: The IMF and WTO

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Summary

The International Monetary Fund (IMF) and World Trade Organization (WTO) approach the issue of currency manipulation differently. The IMF Articles of Agreement prohibit countries from manipulating their currency for the purpose of gaining unfair trade advantage, but the IMF lacks effective means for enforcing that rule. The WTO has rules against export subsidies, but these are very narrow and specific and do not seem to encompass currency manipulation. Several options might be considered for addressing this matter in the future, if policymakers deem this a wise course of action. This report will be updated as conditions require.

This report describes how the International Monetary Fund (IMF) and World Trade Organization (WTO) deal with the issue of currency manipulation. It identifies possible venues for the discussion of currency manipulation. It also discusses apparent discrepancies in their charters and ways those differences might be addressed.

International Financial and Trade Organizations

In the realm of international finance and trade, the IMF and WTO are the most prominent and most important multilateral institutions. They are charged with important tasks for keeping world trade and finance flowing freely.

International Monetary Fund. The IMF is the leading organization in the area of international monetary policy. With the end of the cold war, its membership is now nearly universal. Only North Korea, the Vatican, and four other mini-countries in Europe — none of which have their own currency — are not members of the Fund. The IMF makes loans to countries undergoing financial or balance of payments crises, it provides technical assistance to governments on monetary, banking and exchange rate questions, it does research and analysis on international monetary and economic issues, and it provides a forum where countries can discuss international finance issues and seek common ground on which they can address common problems.

The IMF offers its member countries at least three venues where international economic issues can be discussed. First, the IMF's International Monetary and Finance Committee (IMFC) meets twice annually to review trends in the world economy and identify issues of concern. Second, the IMF Executive Board meets weekly to discuss pending loans and policy issues affecting the Fund. Third, the members of the Fund may meet every five years to discuss whether and by much the financial resources of the IMF should be expanded through a quota increase.

The IMFC operates on a consensus basis and rarely takes formal votes. It is primarily a forum for the exploration of relevant concerns. The chairman's statement, which follows each meeting, summarizes the discussion, outlining the areas of agreement and those where further consultation among the membership is necessary. The report of the IMFC's deliberation serves to guide the Fund's Executive Board and other bodies as they address the issues considered by the IMFC. The IMFC is important because the countries that agree to proposals at those meetings also work later within the international organizations to accomplish those goals. The IMFC can be a good forum for discussing exchange rate issues in a general way, but it is not well suited either to propose changes in exchange rate procedures or to settle disputes between individual countries.

Negotiations about increases in the IMF's resources offer another opportunity where countries can raise policy or organizational issues which concern them. With 16% of the vote, the United States can block the 85% favorable vote necessary to approve any quota increase plan. Other groups of countries can also compile the 15% vote necessary to block agreement. Thus, a broad consensus is necessary for a quota increase to be approved. Generally speaking, these talks are not a good venue for resolving disputes between member countries. The only real leverage that countries have at these meetings is their willingness to withhold their consent to a final agreement. Few countries are likely to be willing to give up a position (the exchange rate value of their currency, for example) that they believe is important to their interests just to get the right to contribute more money and get a few more votes in the IMF.

The IMF Executive Board has the power to approve or deny pending loans and to make changes in the procedures and policies of the IMF. (However, things that require changes in the Articles of Agreement must be referred to the Fund's Board of Governors and approved by 85% of the IMF membership.) The Executive Board has the authority to consider disputes between member countries about interpretation of IMF rules or complaints where one country argues that another is not complying with its obligations under the Articles. If a country does not wish to change its behavior after the Executive Board has ruled against it, the Board has little power — other than the authority to expel the malefactor from membership — to enforce its views. Countries are free to continue the disputed practice, however, after they cease to be a member of the IMF.

The IMF has no authority to tell currency traders what value they should assign to particular currencies as they conduct their commercial operations. Market rates can be affected by decisions that governments make about fiscal or monetary policy or by actions governments take in foreign exchange markets. These actions are often taken with an eye to their impact on exchange markets — and the consequent impact on trade and capital flows — but they are not normally considered to be forms of currency manipulation. The IMF has no authority to tell governments that they should or should not take these actions.

World Trade Organization. The WTO is the central organization in the world trade system. When the WTO was created in 1995, countries were required to accept as a condition of WTO membership the existing set of international trade rules contained in the General Agreement on Tariffs and Trade (GATT), along with obligations that expanded on existing rules and in some cases covered new areas, such as international trade in services and trade-related international property rights.

Unique among the major international trade and finance organizations, the WTO has a rigorous dispute settlement mechanism for enforcing its rules. If a country believes another country has violated the WTO rules, to its detriment, it may request the appointment of a dispute settlement panel to hear its complaint. The other country cannot veto the establishment of a panel or block enforcement of its decision. The panel reviews the arguments in the case and renders judgment based on the facts and WTO rules. If the losing party does not comply with the ruling within a reasonable period of time, the WTO, if requested by the complaining Member, may authorize that Member to impose retaliatory measures (usually customs duties) against that country's goods or to take other appropriate retaliatory measures against that country's trade.

Whether currency issues could fall under the jurisdiction of the WTO remains a debatable proposition. The WTO rules specify that countries may not provide subsidies to help promote their national exports. Most analysts agree that an undervalued currency lowers a firm's cost of production relative to world prices and therefore helps to encourage exports. Under the WTO's strict definition, however, it would be difficult to show that this practice would be an export subsidy.[1]

This is because subsidies are defined, by the WTO, as financial contributions or other income or price support by a government that confers a benefit on the recipient. Export subsidies (i.e., subsidies "contingent on export performance") are expressly prohibited. To challenge a subsidy in the WTO, a subsidy must be specific to an industry; export subsidies, however, are considered specific per se. Government financial support can take a variety of forms, such as direct payments to the exporter, the waiver of tax payments or other revenue that would otherwise be due from the exporter, or special government purchases or the provision of low-cost goods or services (other than general infrastructure) that lowers the cost of production. Even if currency manipulation could be shown to be "financial contribution" or "other income or price support" under WTO rules, it would still have to be shown to be "contingent on export performance," which is likely not the case with respect to the practice at issue.

The guidelines regarding subsidies date from the early days of the current international trade regime. The GATT adopted in 1947 contained a subsidy article (Article XVI); a few changes were made in 1957 and 1962, and an agreement on subsidies was negotiated during the 1973-1979 Tokyo Round of trade negotiations. During most of this period, until the world financial system frayed in the 1970s, the International Monetary Fund exercised strict control over exchange rates. Countries could not change their exchange rates up or down from the level recognized by the IMF by more than 10% without the Fund's consent. Moreover, "A member shall not propose a change in the par

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[1] Agreement on Subsidies and Countervailing Duties, Articles 1 to 3.

value of its currency except to correct fundamental disequilibrium."[2] It was inconceivable during this period that a country could persistently value its currency at a level below that specified by the IMF. Consequently, GATT rules and the trade agreements negotiated during this period did not include any provisions requiring that countries refrain from manipulating their exchange rates for the purpose of stimulating exports. When the IMF's rules were changed in 1978, so that it no longer played its role governing world exchange rates, the GATT's rules were not changed to reflect the new reality of international finance. When the WTO was created in 1995, it adopted the existing GATT rules as its own.

Policy Options in the Multilateral Sphere

Though their roles and responsibilities differ, the IMF and WTO were both created to facilitate sound, stable, and orderly growth in world trade for the purpose of enhancing the living standards and the development of the productive capacity of all countries that participate in it. The IMF was created in 1944, among other things, "to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real employment and to the development of the productive resources of all members as primary objectives of economic policy."[3] The WTO was created in 1995 for a similar purpose. The agreement establishing the WTO also says that the members recognize "that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a steady growing volume of real income and effective demand, and expanding the production of and trade in goods and services" in order to achieve sustainable development, protection and preservation of the environment and to do this in a manner "consistent with their respective needs and concerns at different levels of economic development."[4]

A number of countries have been suspected or accused in recent years of manipulating the value of their currency for the purpose of gaining unfair trade advantage. The IMF Articles of Agreement prohibit this sort of behavior, but the Fund has no capacity to enforce that prohibition. By contrast, the WTO has the capacity to adjudicate trade disputes, but to date there has not been a dispute settlement ruling or other WTO decision making clear that the WTO has responsibility or authority to address suspected issues of currency manipulation. In other words, the IMF's Article IV prohibits currency manipulation for the purpose of gaining unfair trade advantage, but it cannot stop it. WTO dispute settlement could be used as a vehicle to deter countries from engaging in impermissible trade practices, but it is far from clear that currency manipulation would be considered to be a subsidy and that the trade it generates would thus be considered to be unfairly subsidized. Should policymakers wish to address this situation, several options (discussed below) might be considered.

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[2] This language is quoted from Section 5 of the original language of Article IV as approved by the 1944 Bretton Woods conference and confirmed by all member countries when the IMF officially came into existence in 1946.

[3] Articles of Agreement of the IMF, Article I. Six purposes for the establishment of the IMF are cited. This is the second.

[4] Agreement Establishing the World Trade Organization, 1995, preamble.

Amend the Articles of the IMF. One option for proponents of steps to address the issue of currency manipulation might be changes in the IMF's Articles of Agreement that would give it more authority over the international exchange rate system and more capacity to require country compliance with IMF rules. This would restore, to some degree, a large measure of the authority over exchange rates that the IMF possessed when it first came into being in 1946. Two objections might be raised, however.

First, an 85% majority vote of the IMF member countries would be required for any change in the IMF Articles of Agreement. Most countries seem to believe that the present system of floating and fixed exchange rates is working reasonably well, despite concerns about possible currency manipulation by some countries. There does not appear to be the kind of broad agreement on the need for changes — and agreement as to what those changes should be — that would be necessary to amend the IMF's basic rules.

Second, few countries want the IMF to have the kinds of power over their economies that it would need if it were able to compel countries to comply with its rules. For example, if the IMF had the power to declare China's currency to be undervalued and to require changes, it would also have a corresponding power to declare the U.S. dollar or the Euro to be overvalued and to require the United States or the Euro zone countries to make changes in their domestic policies sufficient to correct that situation.

Amend the WTO Agreements. Another possibility might be a formal change in the WTO agreements to give WTO Members an effective way to address currency manipulation with the intent or effect of gaining unfair advantages in world trade. Most effective in discouraging the practice would seem to be a change or clarification in the WTO definition of "subsidy" so that currency undervaluation constituted a subsidy and thus undervaluation that was contingent on export performance would be prohibited, just as direct payments to exporters are prohibited today. To preserve the prerogatives of the IMF, the WTO would likely need to ask the Fund's executive board to determine whether a currency is being manipulated before disputes based on that allegation could be considered by a dispute settlement panel.

It would not be easy to amend WTO agreements, however, because the amendment process is complex and in practice the unanimous consent of all WTO Members would likely be needed. Countries with undervalued currencies could easily block the adoption of the amendment. However, they would have to act in public, and they would have to argue in effect that Article IV should not be mandatory as far as their trade is concerned. It is not very likely that an amendment could be adopted by this means. Most likely, a change of this sort in WTO agreements would occur through multilateral trade negotiations, during which the United States and like-minded countries would trade this change for some other change desired by countries with the other point of view.

Improve the IMF-WTO Agreement. An alternative approach might be efforts to strengthen the existing interagency agreement between the WTO and the IMF. The present agreement was signed in 1996 and updated in mid-2006. Among other things, it stipulates (paragraph 1) that the two organizations "shall cooperate in the discharge of

their respective mandates."[5] It says (paragraph 2) the two agencies "shall consult with each other with a view to achieving greater coherence in global economic policymaking." It also says (pargraph 8) that the two agencies shall communicate with each other about "matters of mutual interest."

It is unreasonable to expect that one international organization will enforce the rules of another international organization. This is particularly the case if the one body lacks the capacity to enforce its own rules and if the activities in question are not violations of the other body's rules. On the other hand, it is reasonable to think that one might advise the other that its operations were hindering the first "in the discharge of" its assigned duties. The WTO's and IMF's different approaches to the question of exchange rate manipulation do not seem to be steps toward "greater coherence in global economic policymaking." This would seem to be the kind of situation for which a communication about "matters of mutual interest" might be appropriate. As best as can be determined, the IMF has not formally communicated views on this matter to the appropriate authorities of the WTO.

Amendments to the IMF-WTO interagency agreement might help clarify or perhaps ameliorate the situation. Any member country government may propose that changes be made in an existing agreement or that the decision-making bodies of the two organizations consider adopting new interagency agreements. The IMF's Executive Board and the WTO's Ministerial Conference and Governing Council can make ordinary decisions by majority vote. This seems to include approval of compacts with other international bodies. Neither may use such agreements to amend their basic rules or to fundamentally change their operating procedures in violation of their respective charters.

Currently, it is difficult for one WTO member country to protect itself from unfair trade from another country if that trade is generated by currency manipulation rather than by the kinds of direct subsidies prohibited by the WTO. In this case, the country that manipulates its currency in order to expand unfairly its international trade could complain that another country was violating the rules of the WTO if it took steps to protect itself from the unfair trade generated by the complaining country's currency maneuvers, for example, by placing tariff surcharges on the complaining country's imports.

There may be grounds for improving WTO-IMF collaboration in this respect. No agreement between them can change their basic rules. However, they could agree that their disparate treatment of currency manipulation is anomalous and inconsistent with their promise to "cooperate in the discharge of their respective mandates" and to promote "greater coherence in global economic policymaking." They could agree to work together to identify and to mitigate areas where their rules and procedures were not consistent or not mutually supportive and to identify areas where policy or institutional changes might be needed if their Members wish to address this problem. They could also agree that the WTO should ask the IMF to determine whether a country were manipulating its currency for the purpose of preventing adjustment or gaining unfair trade advantage if the issue arises in the WTO. No such requirement currently exists.

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[5] Agreement Between the International Monetary Fund and the World Trade Organization, updated June 30, 2006. See [http://www.imf.org/external/pubs/ft/sd/index.asp?decision=DN26].