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Biting the Hand that Feeds Us: A Critical Analysis of U.S. Policy Trends Concerning Chinese Currency Manipulation

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BITING THE HAND THAT FEEDS US: A CRITICAL ANALYSIS OF U.S. POLICY TRENDS CONCERNING CHINESE CURRENCY MANIPULATION

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I. SHIFTING CHINESE POLICY: FROM A PEG TO A BASKET

Between 1994 and July 2005, China maintained a fixed exchange rate, or peg, of 8.28 renminbi[1] (RMB) or yuan, per U.S. dollar.[2] For many years,

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1. Literally translated, Renminbi means "the people's currency" while the term "Yuan" is reserved as a unit of measurement used when counting (one yuan, two yuan, three yuan, and so on).

2. Wayne M. Morrison & Marc Labonte, *China's Currency Peg: A Summary of the Economic Issues* 2005, CRS Report RS2162517, July 11, 2007, at CRS-1, *available at* http://fas.org/sgp/crs/row/RS21625.

China's peg was equal to that which prevailed in the market, and so the Chinese government did not need to take any action to keep the supply of RMB in line with demand.[3] However, as the relative demand for Chinese goods and services increased, more RMB were required to purchase those goods and services, resulting in an upward pressure on the value of the RMB.[4] Rather than allow the currency to naturally appreciate against the dollar, the Chinese government continued its fixed exchange rate policy. As justification for these measures, the Chinese government cited economic instability and an underdeveloped banking system, among other things.[5]

At the first sign of an appreciating RMB, the Chinese government responded by increasing the supply of RMB and decreasing the supply of another nation's currency by purchasing that nation's currency on the currency market, thus restoring the desired equilibrium.[6] In this way, China employed a combination of domestic and international monetary policies to relieve the upward pressure on the RMB and maintain the pegged value of its currency.[7]

The Chinese government used strict capital controls as a primary tool when increasing or decreasing the supply of RMB.[8] For example, the Chinese government required firms in China to exchange most of their hard currency earnings to the central government in exchange for RMB.[9] While the Chinese government did eventually allow the RMB to be freely convertible "for purposes of trade in goods and services," capital transactions remained subject to strict controls to curtail unpredictable flows of capital into or out of the country.[10] This meant that while the RMB was convertible for trade transactions, it was still not freely

3. Wayne Morrison & Marc Labonte, *China's Exchange Rate Peg: Economic Issues and Options for U.S. Trade Policy*, CRS Report RL3216517, July 15, 2007, at CRS-3, *available at* http://www.fas.org/sgp/crs/row/RL32165.pdf.

4. *Id.*

5. Morrison & Labonte, *supra* note 2, at CRS-2.

6. Morrison & Labonte, *supra* note 3, at CRS-4.

7. Xinchen Sofia Lou, *Challenging China's Fixed exchange Rate Regime: An Analysis of U.S. Options*, 28 HASTINGS INT'L & COMP. L. REV. 455, 457-58 (2005).

8. Wayne M. Morrison, *China-U.S. Trade Issues* 2006, CRS Report IB91121, July 1, 2005, at CRS-S, *available at* http://fas.org/sgp/crs/row/IB91121.

9. *Id.*

10. Lou, *supra* note 7, at 458-59. This language came from China's adoption of the International Monetary Fund article VIII. *See* Articles of Agreement of the International Monetary Fund [hereinafter IMF Articles], 60 Stat. 1401, 2 U.N.T.S. 39, art. VIII (1944), *available at* www.imf.org/external/pubs/ft/aa/aa08.htm#2.

convertible for other types of financial flows such as portfolio investments.[11]

To maintain its peg, the Chinese government also implemented strict controls over the trading of the RMB. This tactic assured that the RMB's value floated within a narrow band around the peg.[12] The Chinese central bank, the People's Bank of China (PBOC), is the sole issuer and controller of the RMB. Rather than allow the RMB to trade in the global currency market, the PBOC determined daily what the exchange rate would be and authorized trading only in a narrow band around its announced exchange rate.[13]

Finally, under its fixed exchange rate system, the PBOC bought billions of dollars on the currency markets in the form of U.S. Treasury bonds and other foreign securities.[14] These large purchases of foreign exchange, specifically U.S. dollar denominated assets, effectively decreased global supply of the currency, raising the RMB's value until it once again fell within the desired range of the peg.[15] As of the date of this Note, China has accumulated in excess of one trillion dollars in foreign exchange reserves, approximately 70% of which are in U.S. currency.[16] Of this $700 billion, $339 billion is in the form of U.S. Treasury bonds.[17]

China was not the first country to use a fixed exchange rate.[18] However, the increasing amount of trade between the United States and China,[19] as

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11. Morrison & Labonte, *supra* note 2, at CRS-2 n.3.

12. *Id.* at CRS-1.

13. Lou, *supra* note 7, at 457-58. In order to gauge the relative worldwide level of demand for the RMB, the PBOC created an inter-bank exchange market consisting of a select number of authorized foreign exchange banks and financial institutions. The member banks were given a predetermined exchange rate with respect to four major currencies (the U.S. dollar, the Euro, the Hong Kong dollar, and the Japanese Yen) every day and were prohibited from trading the RMB outside of a narrow band around the announced rate. *Id.*

14. Paul Blustein, *Putting Pressure on China's Peg: U.S. Wants Change in Currency Policy, but Benefits Aren't Clear-Cut*, WASH. POST, May 11, 2005, at E01, *available at* www.washingtonpost.com/wp-dyn/content/article/2005/05/10/AR2005051001460.html.

15. Jonathan E. Sanford, *China's Currency: Brief Overview of U.S. Options* 2005, CRS Report RS22338, Nov. 29, 2005, *available at* http://fpc.state.gov/documents/organization/57797.pdf.

16. Marisa Morrison, *A Chinese Currency Conundrum*, National Interest Online, http://www.nationalinterest.org/Article.aspx?id=13188.

17. *See id.*

18. Morrison & Labonte, *supra* note 3, at CRS-7. From the 1940s to the 1960s, the Bretton Woods system linked the major currencies of the world. Prior to this time, the international gold standard was also widely used to set exchange rates.

19. The total trade between the United States and China was $387 billion in 2007, up from $343 billion in 2006, $285 billion in 2005, and just $5 billion in 1980. U.S. Census Bureau, Foreign

well as a ballooning trade deficit between the countries,[20] brought the value of the RMB into focus as a growing point of contention beginning in 2003.[21] As pressure mounted from the United States and other countries for China to alter its economic policies,[22] the Chinese government began seeking an alternative to its currency peg.

The most common alternative to a fixed exchange rate is a floating exchange rate in which market supply and demand cause a currency's exchange rate to continually fluctuate.[23] Many countries, such as the United States and the countries of the European Union, have decided to implement free floating exchange rates. China, however, has expressed concern about completely abandoning the peg in favor of a free floating currency.[24] The cause of this reluctance is the perceived economic weakness in key economic sectors such as the banking, insurance, and export industries.[25] Chinese officials have also been concerned that a rapid shift in currency policy might spark an economic crisis which would ultimately lead to political unrest.[26]

With great trepidation, China announced on July 21, 2005 that it would abandon its decade old currency peg in favor of a new hybrid exchange rate system.[27] The PBOC announced three major policy shifts that would occur under this new system. First, the value of the RMB would be appreciated from 8.27-8.11 RMB/USD, a 2.1% increase.[28] Next, the new hybrid exchange rate would remove the ridged dollar peg and instead, link the RMB to a basket of currencies.[29] While the exact composition of the currency basket is only known to Chinese authorities, it is widely

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Trade Statistics, http://www.census.gov/foreign-trade/balance/c5700.html#2007.

20. The trade deficit with China, while still growing, is showing some signs of slowing down thanks in part to a weakened dollar which has made U.S. exports more affordable. The total 2007 U.S. china trade deficit was $256.3 billion, up from $232.6 billion in 2006, and $202 billion in 2005. *Id.*

21. Lou, *supra* note 7, at 455.

22. In 2001 Japan argued that the RMB was undervalued and that it gave Chinese exporters an unfair advantage. *See* Paul Wiseman, *China's Currency Flexes Its Muscle*, USA TODAY, Dec. 19, 2001, at 5B.

23. Morrison & Labonte, *supra* note 3, at CRS-3.

24. Morrison & Labonte, *supra* note 2, at CRS-2.

25. *Id.*

26. *Id.*

27. Yumi Kuramitsu, *China Ends Yuan Dollar Peg, Shifts to Currency Basket*, July 21, 2005, http://quote.bloomberg.com/apps/news?pid=10000006&sid=a04ESaRrTpcU&refer=home (last visited Dec. 17, 2007).

28. *Id.*

29. *Id.*

speculated that the basket includes the euro, the yen, the U.S. dollar, as well as other Asian currencies.[30] Finally, the central bank announced that the RMB would be allowed to fluctuate by 0.3% each day above or below a central parity, and further that, "the closing price of . . . the U.S. dollar traded against the RMB . . . after the closing . . . of the market each working day would become the central parity for the . . . following working day."[31] Economists commonly call this type of hybrid exchange rate system a "crawling peg."[32]

Many experts view this policy shift as an indication of additional, future appreciations of the RMB.[33] Jens Nordvig, a currency strategist at Goldman Sachs Group Inc., believed that "what they're really doing is leaving the door open to further revaluations. By not pegging the yuan to the dollar, it gives the Chinese more flexibility to engineer a gradual appreciation."[34] Had this new policy been allowed to function as announced, the RMB could have risen by as much as 30% in five months.[35]

Nevertheless, on July 27, 2005, the PBOC announced that it expected no further appreciation of the RMB and that instead of a "crawling peg," the RMB would be subject to a "managed float."[36] The difference between the two systems is hardly semantic. Rather than allow the RMB to appreciate the full 0.3% per day as was announced, the PBOC considered the daily changes of the RMB relative to the currencies in the basket and decided what the appropriate exchange rate would be.[37] Additionally, the central bank reserved the right to determine when and how any further appreciation should occur.[38]

These two latest announcements seemed to be at odds with one another and economic experts and commentators alike offered at least three interpretations as to the nature of the discrepancy.[39] First, some pointed to these inconsistent policies as evidence of the ongoing internal struggle in

30. Peter S. Goodman, *China Ends Fixed-Rate Currency: Administration Hails Policy Shift*, WASH. POST, July 22, 2005, at A01, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2005/07/21/AR2005072100351.html.

31. Sanford, *supra* note 15, at CRS-4.

32. *Id.*

33. Kuramitsu, *supra* note 27.

34. *Id.*

35. Sanford, *supra* note 15, at CRS-4.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

China between those who want to liberalize the RMB and those who want to retain its sub-market value.[40] Second, it was argued that the new system was put in place simply as a facade, designed to distract the international community.[41] Finally, a third view was that China issued the two conflicting announcements to confuse currency speculators.[42]

As of the date of this Note, the RMB has made some notable gains against the U.S. dollar; however, this appreciation has been largely due to the broad based decline in value of the U.S. dollar precipitated by the recent ongoing problems in the U.S. economy.[43] Since the announcements in July 2005, there have been no further declarations from Chinese officials that might clarify or otherwise disclose any policy position that the PBOC might take with respect to the RMB.[44] Despite repeated and persistent requests from the international community,[45] China has consistently declined to comment about any future plans to revalue its currency.[46] Some currency experts speculate that China will wait until its domestic economy is stronger to revalue the RMB.[47] Others, however, are calling for urgent action.[48]

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40. Sanford, *supra* note 15, at CRS-4. If this theory is correct, it would suggest that foreign attempts to influence China's monetary policy could backfire. Foreign influence might strengthen the hand of those in China who are resistant to change.

41. *Id.* China was scheduled to meet with officials from the International Monetary Fund on August 3, 2005. In its 2004 meeting the IMF Board expressed some criticism of the Chinese exchange rate system, suggesting that in 2005 China should make an effort to introduce more market forces into its exchange rate policy. The advent of the new regime gave Chinese officials something new to present, effectively buying China at least one more year.

42. *Id.* The July 27 announcement introduced the possibility that the value of the RMB might increase, decrease, or stay the same. China must eventually appreciate its currency, as speculators expect, but it must balance this priority against its interest in discouraging speculators from bringing more money into the country.

43. As of March 24, 2008, the latest exchange rate is 7.06 RMB per U.S. dollar. *See* x-rates.com, Chinese Yuan to 1 USD, http://www.x-rates.com/d/CNY/USD/graph120.html (last visited Mar. 24, 2008).

44. Sanford, *supra* note 15, at CRS-4-5.

45. The list of people and groups that have called on China to clarify its currency position include the IMF Board, G-8 summit members, Japanese economic officials, U.S. Treasury Secretary John Snow, President Bush, as well as the governing boards of both the IMF and the World Bank. *Id.*

46. Sanford, *supra* note 15, at CRS-5.

47. *Id.*

48. *Id.*

II. THE CONTROVERSY

In order to understand why China's currency peg was, and continues to be, so controversial one must first understand the nature of the competing interests involved. Both China and the United States shared benefits and burdens under the fixed peg system, as well as the "managed float" system. This portion of the Note examines Chinese and U.S. perspectives on former and current Chinese currency policy.

A. *U.S. Perspective*

In mid-2003 currency analysts in the United States began expressing concern that China's currency is undervalued.[49] Many accuse China of manipulating its currency by its continual adherence first to the peg, and now to a "managed float" that is substantially below fair market value.[50] Those who accuse China of currency manipulation[51] believe that the ultimate goal of Chinese monetary policy is to gain an unfair trade advantage which will lead to export-led growth.[52] Allegedly, these mercantilist practices have resulted in serious injury to the U.S. manufacturing sector[53] and have greatly contributed to the U.S. trade

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49. Lou, *supra* note 7, at 455.

50. Morrison, *supra* note 8, at CRS-6.

51. The label of "currency manipulator" is ultimately imposed by the Secretary of Treasury. 22 U.S.C. § 5304(b) (2007) says,

> The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. If the Secretary considers that such manipulation is occurring . . . the Secretary of the Treasury shall take action to initiate negotiations with such foreign countries on an expedited basis.

22 U.S.C. § 5304 (2007).

52. L. Josh Bivens & Robert E. Scott, *China Manipulates Its Currency-A Response is Needed,* EPI Policy Memorandum #116, Economic Policy Institute (Sept. 26, 2006) *available at* http://www.epinet.org/printer.cfm?id=2500&content_type=1&nice_name=pm116. *See also* U.S.-China Economic and Security Review Commission [hereinafter ESRC], *2006 Report to Congress,* Nov. 2006, at 2-3.

53. Many critics of China's policy claim that,

deficit.[54] In addition to influencing the U.S. economy, some analysts have also maintained that China's currency peg influences other East Asian countries to manipulate their currencies to remain competitive with Chinese goods.[55]

This view is held by several interested groups including, but not limited to, the U.S.-China Economic and Security Review Commission[56] (ESRC), many manufacturing sector representatives,[57] and labor unions.[58] Every one of these groups has protested China's currency policies and lobbied lawmakers for legislative reforms that protect against further loss of American jobs.[59]

Interestingly, even among the critics of Chinese currency policy, there seems to be no consensus as to how much the RMB is undervalued.[60] Ernest Preeg, a senior fellow of the Manufacturer's Alliance, estimates that the RMB is undervalued by 40%.[61] The Institute for International

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> between 2000 and 2003, annual manufacturing employment in the United States declined by almost 3 million jobs, and has been largely flat since then. The level of manufacturing employment in 2003 was 14.3 million, the lowest since 1950. [. . .] In addition, the trade deficit in manufactured goods rose by $84 billion between 2000 and 2003 and it is currently on pace to grow by another $150 billion by the end of 2005 (for a total deficit increase of $234 billion in the 2000-05 period). The relationship between trade deficits in manufactured goods and manufacturing employment seems obvious: imports decrease labor demand in manufacturing while exports spur this demand. A rising trade deficit means, all else equal, that labor demand in U.S. manufacturing is reduced.

L. Josh Bivens, Trade Deficits and Manufacturing Job Loss: Correlation and Causality, *available at* http://www.epi.org/content.cfm/bp171 (footnotes omitted).

54. *See* Bivens & Scott, *supra* note 52.

55. *See* Prepared Remarks of Dr. C. Fred Bergsten, President, Institute for International Economics, Before the House Small Business Committee, June 25, 2003.

56. *See* ESRC, *supra* note 52.

57. Many manufacturing sector representatives believe that the United States is in a manufacturing recession because over 90% of the total U.S. job losses since 2000 have come from the manufacturing sector. Because of the ballooning trade deficit, they have singled out China as the biggest direct threat to U.S. manufacturers and the largest single source of job losses. Lou, *supra* note 7, at 460.

58. The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), the largest labor union in the United States, wants lawmakers to pass legislation that is "feasible, quick, and will begin to ameliorate the job losses." *Id.* at 461.

59. *Id.*

60. Morrison, *supra* note 8, at CRS-6.

61. Preeg however, does not use a scientific analysis but rather relies on several observational estimates to reach his conclusion. Ernest H. Preeg, *Exchange Rate Manipulation to Gain an Unfair Competitive Advantage: The Case Against Japan and China*, *in* DOLLAR OVERVALUATION AND THE

Economics (IIE) believes that the RMB is approximately 15-25% undervalued.[62] Goldman Sachs Economic Research Group has placed RMB undervaluation at about 9.5-15%.[63] Economist Jeffery Frankel's model estimates that the RMB was undervalued by as much as 35% in 2000.[64] While no new data has become available for use in his model, Frankel speculates that the undervaluation has only increased since the model's date.[65] Finally, an oft cited estimate based on the *Economist* magazine's Big Mac Index[66] places RMB undervaluation at 58%.[67]

The variance in these results is no doubt a function of the exceptionally diverse methods used in their respective calculations. Some of these models use highly sophisticated economic formulae, others rely on generic "rules-of-thumb," and at least one simply compares the price of a Big Mac sandwich in each country. "Participants in the debate about China's currency seem to select the studies they quote more because they like their conclusions than because they have determined that their underlying methodology and assumptions are more correct."[68] For all their differences, policymakers and economic scholars agree that the RMB is undervalued by 15-40%.[69]

The degree of undervaluation is significant because, to the extent the RMB is undervalued, Chinese exports to the United States receive a government "subsidy" and thereby become cheaper than U.S. goods. Conversely, U.S. imports to China are "taxed," making them more expensive than they would otherwise be.[70] This result has particularly injured the textile, furniture, plastics, machine tools, and tool and dye industries, which have borne the brunt of low cost competition from

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WORLD ECONOMY 267-71 (C. Fred Bergsten & John Williamson eds., 2003). *See also Chinese Currency Manipulation*, Testimony of Ernest H. Preeg, Ph.D., Before the U.S. Committee on Banking, Housing, and Urban Affairs, May 1, 2002.

62. Morris Goldstein, Testimony Before the Subcommittee on Domestic and International Monetary Policy, Committee on Financial Services, U.S. House of Representatives, Oct. 1, 2003.

63. Jim O'Neill & Dominic Wilson, *How China can Help the World* (Goldman Sachs Global Econ. Paper No. 97, 2003).

64. Jeffrey Frankel, *On the Renminbi*, 6 CESIFO FORUM 16 (2005), *available at* http://ksghome.harvard.edu/~jfrankel/ChinaYuanpub05CES-Ifo.pdf.

65. *Id.* at 8.

66. The Big Mac Index (BMI) is portrayed as a "light hearted guide" to exchange rates. The BMI compares the price of a McDonald's Big Mac Sandwich in China to that in the United States. Morrison & Labonte, *supra* note 3, at CRS-13.

67. *Economic and Financial Indicators*, ECONOMIST, Dec. 18, 2004, at 194.

68. Sanford, *supra* note 15, at CRS-2.

69. Morrison, *supra* note 8, at CRS-6.

70. *Id.*

Chinese products.[71] Representatives from these industry sectors, as well as others, have strenuously lobbied Congress and the Bush Administration to pressure China into appreciating its currency or allowing it to freely float.[72]

Some members of Congress have taken this request very seriously and introduced several bills in the 109th Congress that called for action on the part of the President, as well as the U.S. Trade Representative (USTR). One bill, sponsored by Senators Lindsey Graham and Chuck Schumer, proposed a 27.5% across the board tariff on all products from China if it failed to substantially revalue its currency to market levels.[73] While the senators withdrew the bill in September 2006, some believe the bill would pass if put to a vote.[74] As of the date of this Note, four more bills have been introduced in the 110th Congress which address the same issues and propose measures substantially similar to penalties.[75]

President Bush publicly criticized the Chinese currency peg[76] and raised the issue during meetings with Chinese President Hu Jintao.[77] Although the Bush Administration initially rejected a direct pressure approach, its position on the peg seemed to toughen in April 2005 when U.S. Treasury Secretary John Snow declared that, "China is now ready to move to a more flexible exchange rate and should move now."[78] Shortly after this and other statements were issued, the PBOC announced its new "managed float" in July 2005.[79]

China's move to a basket of currencies was met with mixed reactions. Many U.S. policymakers praised the move as a positive step in the right direction; however, some were disappointed at the relatively small revaluation and called on China to further appreciate the RMB.[80] When it became apparent that the PBOC had no further plans to appreciate the RMB beyond the initial 2.1% increase, the mood in Washington decidedly

71. *Id.*

72. *Id.*

73. *See* S.14, S.295, & H.R. 1575, 109th Cong. (2005).

74. Morrison, *supra* note 16. The bill received 67 votes in a procedural vote.

75. *See* H.R.1002.IH, H.R.321.IH, S.796.IS, and H.R.782.IH, 110th Cong. (2007), *available at* http://thomas.loc.gov/home/c110query (using site to search for individual bills).

76. During an interview with CNBC's Ron Insana on Sept. 5, 2003, President Bush stated that exchange rates should be determined by market forces. Interview by Ron Insana with George W. Bush, President of the United States (Sept. 5, 2003).

77. Morrison, *supra* note 8, at CRS-7.

78. *Id.* In a May 17, 2005 report, the Treasury Department described China's exchange rate policy as "a substantial distortion to world markets." *Id.*

79. *See* Sanford, *supra* note 15, at CRS-4.

80. Morrison, *supra* note 8, at CRS-7. *See also* Morrison, *supra* note 16.

changed.[81] In November 2005, the Treasury reported that China's actions were "not sufficient and do not represent fulfillment of the Chinese authorities' [earlier] commitment."[82] The Treasury's November report stopped short of officially labeling China as a currency manipulator.[83] Instead the report concluded that China's new system bore a strong resemblance to its old system of pegging the RMB to the dollar.[84]

B. *Chinese Perspective*

Chinese officials have vehemently denied that the peg was ever put in place to obtain an unfair trade advantage vis-à-vis the United States.[85] Rather, they have claimed that a fixed exchange rate was needed to promote domestic economic stability and international monetary credibility.[86] China has repeatedly assured the international community that it eventually plans to move to a freely floating currency, but that it will not do so until Chinese officials are convinced that the domestic economy is strong enough.[87] Chinese officials are concerned that abandoning the current currency policy too quickly would cause an economic crisis in China and would cripple the export industry at a time when crucial economic reforms are being made.[88]

One of the biggest areas of concern for Chinese officials is China's underdeveloped banking system.[89] The banks in China are predominantly state owned and are often called upon to make low-interest loans to other state owned enterprises without regard to typical lending requirements such as creditworthiness, collateral, and other risk assessments that market driven lenders demand.[90] The banks are also called upon by their government to carry large amounts of defaulted loans on their balance

81. *See* Morrison, *supra* note 8, at CRS-7.

82. U.S. Department of the Treasury, *Report to Congress on International Economic and Exchange Rate Policies*, at 18, Nov. 2005, *available at* http://www.treas.gov/offices/international-affairs/economic-exchange-rates/112005_report.pdf.

83. *Id.* at 17-21.

84. *Id.*

85. Morrison & Labonte, *supra* note 2, at CRS-2.

86. Morrison & Labonte, *supra* note 3, at CRS-6-7.

87. Morrison, *supra* note 8, at CRS-6.

88. For the past several years, China has been undergoing the process of closing down inefficient state-owned factories and privatizing them, as well as a pervasive restructuring of the state banking system. Morrison, *supra* note 8, at CRS-6.

89. Morrison & Labonte, *supra* note 3, at CRS-2.

90. ESRC, *supra* note 52, at 5.

sheets and forgive such debts held by state owned enterprises.[91] Given the current status of the banking system, Chinese officials doubt that it would be able to effectively deal with the speculative pressures that could occur with a floating exchange rate.[92] Even the U.S.-China ESRC, a group that has staunchly advocated confronting China over its currency practices, has recognized that "serious and potentially crippling problems threaten the financial system in China and render it vulnerable to excessive volatility and collapse."[93]

The Chinese government views economic stability as essential for maintaining long-term political stability.[94] It is a widely held view that the 1997-1998 Asian financial crisis was caused largely by the combination of poorly regulated financial systems and fully convertible currencies.[95] The Chinese government fears a similar situation in which an appreciating RMB reduces foreign investment, causes deflation, reduces employment, lowers wages, and ultimately causes worker unrest.[96] Ironically, during the Asian financial crisis when many other nations substantially devalued their currencies, China "held the line" and did not devalue the RMB.[97] This move, which averted further devaluations across Asia was highly praised by many U.S. officials.[98]

In fact, many academics, economists, and financial analysts in the United States still support the Chinese currency model and see no immediate need to force China to change it. Douglas J. Holtz-Eakin cited research that indicated any appreciation in the RMB would not directly translate to appreciation in the price of goods at all.[99] Some have commented that even if goods from China appreciated at a rate equal to the appreciation of the RMB, goods from other countries would simply fill the gap left behind.[100] Morris Goldstein has said Chinese revaluation alone will not help the U.S. trade deficit, but rather, a very broad depreciation of

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91. *Id.*

92. Morrison & Labonte, *supra* note 3, at CRS-3-4.

93. ESRC, *supra* note 52, at 5. Other areas of concern in the Chinese economy include the insurance sector, as well as China's fledgling stock market.

94. Morrison & Labonte, *supra* note 3, at CRS-4.

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. Eakin is the Director of the nonpartisan Congressional Budget Offices. Blustein, *supra* note 14 (citing Eakin, the Director of the Nonpartisan Congressional Budget Offices).

100. *Id.*

the dollar is necessary.[101] Ronald McKinnon cautions a Chinese revaluation might cause a "mirror-image financial crisis."[102] Jeffery Frankel[103] warns, "It is not even true that an appreciation of the renminbi against the dollar would have an immediately noticeable effect on the overall U.S. trade deficit or employment."[104]

International economic scholars have also weighed in on this topic. International Monetary Fund (IMF) experts acknowledge that while China's current situation is not sustainable in the long run, the rise in the value of the RMB should be gradual.[105] Nobel economics laureate, Robert Mundell, has strongly advocated for China to retain its currency peg and to slowly and methodically pursue a course of currency liberalization.[106] Mundell is also of the view that a revaluation of the RMB would have little effect on the root causes of America's dissatisfaction.[107]

Some of the most compelling statements in support of Chinese currency policy come from former U.S. Federal Reserve Chairman Alan Greenspan. From his superior vantage point on the U.S. economy, Greenspan says he disagrees with the "conventional wisdom" that U.S. job

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101. Morris Goldstein, *China's Exchange Rate Regime*, Peterson Institute for International Economics (Oct. 1, 2003), http://petersoninstitute.org/publications/papers/paper.cfm?ResearchID=66.

102. Robyn Meredith, *China's Currency Consequences*, FORBES.COM, July 7, 2003 (citing McKinnon, a professor of economics at Stanford University), *available at* http://www.forbes.com/2003/07/07cz_rm_0707china.html.

103. Frankel is a professor of capital formation and growth at the Kennedy School of Government at Harvard University. He directs the program in International Finance and Macroeconomics at the National Bureau of Economic Research and is also on the Business Cycle Dating Committee. Appointed by former President Bill Clinton in 1996 to his Council of Economic Advisers, Frankel's responsibilities include international economics, macroeconomics, and environment. Frankel's past appointments include positions at the Federal Reserve, Institute for International Economics, International Monetary Fund, University of Michigan, and Yale. His research includes international finance, monetary and fiscal policy, regional economic blocs, Asia, commodity prices, and international environmental issues.

104. Frankel, *supra* note 64, at 2.

105. Raghuram Rajan. *Remarks on Global Current Account Imbalances and Financial Sector—Reform with Examples from China*, Address to the Cato Institute, Nov. 3, 2005, *available at* http://www.imf.org/external/np/speeches/2005/110305b.htm. Rajan is the director of the IMF's research department.

106. *Mundell: China Should Keep Currency Peg*, June 3, 2005, *available at* http://www.chinadaily.com.cn/english/doc/2005-06/03/content_448457.htm.

107. *Id.*

losses would be mitigated by an appreciation of the RMB.[108] In fact, he believes that Chinese currency appreciation "would be unlikely to have much, if any, effect on aggregate employment in the United States."[109] Greenspan has also reiterated warnings to policymakers to avoid succumbing to political pressures from short-sighted, special interest groups as moving in a protectionist direction could prove to be "unexpectedly destabilizing."[110]

Compounding the failings of the Chinese banking system is the sum of almost one trillion dollars of foreign exchange reserves that the central bank has accumulated.[111] The PBOC has had to greatly restrict monetary growth and regulate capital inflows in order to prevent runaway inflation.[112] Greenspan observed that should this pattern continue, the Chinese government would be "confronted with the choice of an overheated economy, with its potential recessionary consequences, or a curtailing of dollar asset purchases. The later presumably would allow the renminbi to appreciate against the dollar."[113] Roubini and Setser have also found the current situation vis-à-vis the relationship between the United States and Chinese economies to be unsustainable.[114] They say that the United States cannot keep borrowing at its current rate, and also, China cannot continue to accumulate foreign reserves without doing serious damage to its domestic economy.[115] While they urge both countries to take immediate action, they advocate for a measured response that will facilitate an orderly and smooth adjustment.[116] Chinese officials realize that the day is coming when they will eventually have to liberalize the RMB and shift to a policy of domestic led growth, but they are not yet ready to do this.[117]

108. *Greenspan Sees China's Currency Peg Unrelated to U.S. Job Losses*, Dec. 11, 2003 [hereinafter *Greenspan Sees*], *available at* http://canberra.usembassy.gov/hyper/2003/1211/epf409.htm.

109. *Id.* (quoting Alan Greenspan).

110. *Id.* (quoting Alan Greenspan).

111. Sanford, *supra* note 15, at CRS-3.

112. *Id.*

113. *Greenspan Sees*, *supra* note 108.

114. Sanford, *supra* note 15, at CRS-3.

115. *Id.*

116. *Id.*

117. *Id.*

III. AN ANALYSIS OF U.S. POLICY OPTIONS

There are several policy options that the United States could pursue to encourage Chinese currency reform. Each of these options will have a unique combination of costs and benefits to the U.S. domestic economy. It follows that the decision to pursue one particular policy course must be examined with respect to the domestic consequences it carries with it. This section of the Note discusses the various policy responses that the United States has available to it, and their likely legal, political and economic consequences.

A. *Continued International Pressure*

As early as 2001, international pressure began mounting on China to revalue the RMB.[118] Since that time, China has repeatedly assured the international community that it intends to eventually move to a fully convertible currency.[119] This cumulative international pressure has achieved some success as evidenced by the decline of the rise of the decade long peg and the rise of the basket of currencies. Also, from September 2005 to December 2006, the RMB appreciated 7% against the dollar.[120] Although many congressional leaders want to see significantly more appreciation in substantially less time, many commentators speculate that sustained international pressure is the only true method which will produce any long term results.[121]

The Chinese government has its own independent set of priorities that dictate its policies on currency valuation.[122] Chinese officials are considering a transition from an economy based on state ownership and control to a market-based system.[123] The concern with this process transition is that it would put a tremendous amount of strain on China's inefficient and fragmented economy, which cannot generate the employment and domestic resources necessary to sustain the country.[124] China's only way of compensating for domestic inefficiencies is to pursue a policy of export led growth. Given this set of priorities, the PBOC chief

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118. *See* Lou, *supra* note 7, n.1.
119. Morrison, *supra* note 16, at 3.
120. *Id.* at 2.
121. *Id.* at 1.
122. Sanford, *supra* note 15, at CRS-3.
123. *Id.*
124. *Id.*

views unilateral U.S. attempts[125] to influence China's currency policy as "'noises' [which] will not change any of the basic conditions and sequences of China's exchange rate reform."[126]

Ultimately, success may depend on the level of sincerity the Chinese exhibit about converting to a floating currency. If the July 2005 RMB revaluation was only due to international pressure, then additional pressure might lead to further results. However, if the Chinese are sincere about their intent to proceed as fast as possible, then added pressure may also lead to resentment and resistance among opponents of reform.[127]

This policy of exerting international influence on China is tantamount to maintaining the status-quo and will likely not produce the desired economic results that some U.S. policymakers seek. The likely results of such a policy would be that while the nominal exchange rate would vary only slightly as gradual appreciation occurred, the real rate would more rapidly adjust as inflation in the two countries diverged.[128] Despite its immediate shortcomings, it must be stressed that this policy is a long-term strategy. It is designed to produce results at a much later time in the future. The adjustment in the exchange rate would only be realized over time and the pressures on the manufacturing sector would continue to persist.[129] This reality would not be popular among many U.S. politicians whose constituencies focus on the short-term and complain about the growing deficit and losses in manufacturing jobs. Thus the overriding political pressure for immediate results may ultimately exclude a policy which might otherwise accomplish the desired long-term goal.

B. *Restrict Imports*

Alternatively, the United States could choose to restrict Chinese imports by instituting various forms of unilateral legislation. Many, if not all, such legislation would include levying a tariff or some other type of penalty on imports. The tariff would raise the cost of imports to the U.S. consumer and lead to a decrease in their sales. There are five principal

125. Specifically referring to the Schumer-Graham bill which was introduced in the 109th Congress. Paul Blustein, *'Watershed' Yuan Revaluation Has Made Few Waves; China's Currency Has Barely Budged*, WASH. POST, Sept. 21, 2005, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2005/09/20/AR2005092001682.html.

126. *Id.*

127. Sanford, *supra* note 15, at CRS-6.

128. Morrison & Labonte, *supra* note 3, at CRS-42.

129. *Id.*

means by which the United States could use legislation of this type to restrict substantially the flow of Chinese imports.

1. Antidumping Actions

Antidumping laws have existed in the United States for almost a century. If properly implemented, these measures ensure that goods from other countries are priced fairly in the domestic market.[130] Since the date of its enactment, the Tariff Act of 1930[131] has provided the basis for legal enforcement in the United States and has incorporated the appropriate international standards as amended.[132]

"Dumping" is the term given to the sale of imported goods at below fair market value.[133] When such an occurrence causes material injury, or threatens to cause material industry to a domestic industry producing a comparable product, an antidumping action may be brought by members of the affected industry.[134] The Tariff Act allows the United States to conduct an investigation into the alleged dumping by foreign companies and impose restitution in the form of a duty to offset any disadvantage suffered by the domestic industry.[135]

The investigatory duties of the alleged dumping activity are shared between the U.S. Department of Commerce (DOC) and the U.S. International Trade Commission (ITC).[136] The DOC investigates the pricing allegations while the ITC investigates the extent of the injury to the domestic industry and whether it can be classified as a material injury.[137] In determining whether sales of a product are below fair market value, the DOC compares the U.S. price of the good to the normal value of the good in the firm's domestic market, or the price of the good in a third market.[138] However, in determining if a material injury has occurred, the ITC

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130. Joseph A. Laroski, Jr., Note, *NMES: A Love Story Nonmarket and Market Economy Status under U.S. Antidumping Law*, 30 L. & POL'Y INT'L BUS. 369, 372 (1999) (observing that antidumping laws were first passed in 1916).

131. Tariff Act of 1930, ch. 497, tit. VII, subtitle B, 731 (1930) (as amended 19 U.S.C. § 1671 (2004)).

132. This also includes GATT recognition of dumping as an unfair trade practice. *See* Lou, *supra* note 7, n.63.

133. Tariff Act of 1930, 19 U.S.C. § 1677 (2007).

134. *Id.*

135. *See id.* § 1671.

136. *See id.* § 1673.

137. *Id.*

138. *See* Tariff Act of 1930, § 1677(35)(A). If neither value is available, then the DOC will construct a value as a normal value. *Id.* § 1677(18).

considers many factors, including profits, productivity, import volume, price depression, return on investment, market share, and production capacity.[139] If both agencies make affirmative rulings in their respective investigations, then the DOC issues an order imposing a duty equal to the average amount by which foreign market value exceeds the U.S. price.[140]

American industries have been challenging Chinese goods under antidumping statutes for almost 30 years.[141] Because of the undervalued RMB, the cost of goods in China are routinely lower than they would be in the United States. Thus, Chinese goods have often been found to satisfy antidumping criteria, resulting in the imposition of tariffs on those goods.

While the successes of previous antidumping actions might encourage aggrieved parties to continue pursuing this type of relief, there has never been an antidumping action aimed at all products from a single nation. The nature of an antidumping action is inherently limited to one individualized investigation of one specific product from one specific nation.[142] The process is both time consuming and labor intensive and was never designed to be a broad, sweeping measure. Given the limited resources of the DOC and the ITC, an investigation into every Chinese product imported into the United States would be impossible. Antidumping actions have been, and will continue to be, an important safeguard for U.S. industry against unfair trade practices by foreign competitors. However, it cannot function as the vehicle through which the United States seeks to influence Chinese currency policy.

2. Subsidies and Countervailing Duties

Another legislative measure the United States may potentially use to encourage China to reform its currency is the countervailing duties law of the Tariff Act of 1930.[143] This provision of the Tariff Act deals primarily with foreign government subsidies to foreign manufacturers and

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139. *See id.* § 1677(7)(C).

140. *See id.* § 1673.

141. Products investigated include crawfish tail meat, color television sets, ball bearings, iron tables, persulfates, wooden furniture, and automotive replacement windshields. Lou, *supra* note 7, at 466.

142. The DOC has always considered China to be a Non-Market Economy (NME). When considering the factors for valuation of goods from a NME, the DOC must compare the domestic value of the goods to a "market economy country . . . considered to be appropriate." Tariff Act of 1930, 19 U.S.C. § 773(c)(1)(B). *See also id.* § 773(c)(4) (listing other valuing factors of production to be applied in the DOC's calculations).

143. *See* Tariff Act of 1930, 19 U.S.C. § 1671-77 (2007).

exporters,[144] and as amended, the statute further incorporates the GATT provisions on subsidies and countervailing duties.[145] The statute authorizes countervailing duties to be levied against a product only after the United States has determined that the product, or industry, has been subsidized by a foreign government, or an agency of the foreign government.[146] Further, duties cannot be levied unless it can be shown that the subsidization has caused or threatens to cause material injury to a domestic U.S. industry.[147]

The investigatory process for a countervailing duty is almost identical to an antidumping investigation. Both the DOC and the ITC share the responsibilities of the investigation and both agencies must render positive findings in their respective investigations in order for the duty to be levied.[148] Unlike an antidumping action, the DOC is responsible for determining whether there has been a material injury, while the ITC is responsible for deciding whether a product has received a countervailable subsidy under the meaning of the statute.[149]

The determination of whether a subsidy is countervailable is complex and fraught with detailed analysis.[150] The Tariff Act includes an exhaustive definition of what constitutes a countervailable subsidy.[151] Among its many criteria is the requirement that the alleged foreign subsidy be

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144. *Id.*

145. *See id.* § 1671(b). The specific GATT provision is Article XVI. *See* GATT 1994, art. XVI, *available at* http://www.marxists.org/history/capitalism/gatt/ch16.htm.

146. 19 U.S.C. § 1671(a) (2007).

147. *Id.*

148. *Id.*

149. *See generally id.* § 1671(c).

150. 19 U.S.C. § 1677, in part, defines a countervailable subsidy as,

> A subsidy . . . [for] which an authority-
> (i) provides a financial contribution,
> (ii) provides any form of income or price support within the meaning of Article XVI of the GATT 1994, or
> (iii) makes a payment to a funding mechanism to provide a financial contribution, or entrusts or directs a private entity to make a financial contribution, if providing the contribution would normally be vested in the government and the practice does not differ in substance from practices normally followed by governments, to a person and a benefit is thereby conferred. For purposes of this paragraph and paragraphs (5A) and (5B), the term "authority" means a government of a country or any public entity within the territory of the country.

19 U.S.C. § 1677.

151. *See id.*

specific enough to clearly demonstrate intent to benefit a targeted industry, producer, or exporter.[152]

The statute's specificity requirement defines a benefitting subsidy as "a financial contribution," or a transfer of money that takes "any form of income or price support within the meaning of Article XVI of the GATT 1994."[153] Or, the subsidy is classified as specific, if it takes the form of "a payment to a funding mechanism to provide a financial contribution . . . to a person and a benefit is thereby conferred."[154] Additionally, the statute explains a subsidy is not specific if "eligibility is automatic . . . the criteria or conditions for eligibility are strictly followed . . . [and] the criteria or conditions are clearly set forth in the relevant statute, regulation, or other official document so as to be capable of verification."[155] When taken together, the Tariff Act of 1930 operates for the limited purpose of combating subsidies that are beneficial to "an individual firm, industry, or group of enterprises," and not "a government program that benefits all industries."[156]

The Chinese currency policy is a national policy that is applicable to every firm, industry, and enterprise in China. To the extent that it confers upon Chinese products a competitive advantage in the global marketplace, it does so equally, uniformly, and without preference for any one industry vis-à-vis any other. It is difficult to imagine a successful claim under the countervailing duty statutes because of the stringent specificity requirements that a subsidy must fulfill before triggering the statute's enforcement. Unless the statutes are amended to define a subsidy in much

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152. *See id.*

153. The material portions of Article XVI § B(4) of the GATT 1994 are as follows:

> Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.

GATT 1994, art. XVI § B(4).

154. 19 U.S.C. § 1677.

155. *Id.* § 1677(5A)(D)(ii).

156. STEPHEN D. COHEN ET AL., FUNDAMENTALS OF U.S. FOREIGN TRADE POLICY: ECONOMICS, POLITICS, LAW, AND ISSUES 172 (2d ed. 2003).

broader terms, U.S. industries will continue to fail in attacking Chinese currency policy under this legislation.

3. Congressional Legislation

In recent years, Congress has shown a growing willingness to address the issue of Chinese currency manipulation. A total of nine bills concerning Chinese currency practices were introduced into the 108th Congress in September and October 2003.[157] Seventeen bills on the same issue were introduced in the 109th Congress.[158] As of the date of this Note, several new bills have been introduced just four months into the 110th Congress concerning China's currency manipulation.[159] All these bills are targeted at China to encourage it to liberalize the RMB and call on the Bush Administration to take more forceful action to facilitate reform of Chinese currency policies.[160]

A few of these bills have proposed a 27.5% tariff on all imported Chinese goods.[161] These bills were drafted under the assumption that the RMB is artificially undervalued by an average of 27.5%, which acts as a

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157. Lou, *supra* note 7, n.45 and accompanying text.

158. Morrison, *supra* note 8, at CRS-14-16.

159. All pending bills may be viewed at the following Library of Congress Web Site: http://thomas.loc.gov/ (last visited Nov. 8, 2007).

160. *See id.*

161. Several bills include a tariff portion as a potential remedy to the current situation. Among them are:

> 1. Unfair Chinese Automotive Tariff Equalization Act (Introduced in House), H.R.388.IH, 110th Cong. (2007).
> 2. Resolved (Introduced in Senate), S. RES.123.IS, 110th Cong. (2007).
> 3. Stopping Overseas Subsidies Act (Introduced in Senate), S.974.IS, 110th Cong. (2007).
> 4. Nonmarket Economy Trade Remedy Act of 2007 (Introduced in House), H.R.1229.IH, 110th Cong. (2007)
> 5. Trade Law Reform Act of 2007 (Introduced in House), H.R.708.IH, 110th Cong. (2007).
> 6. Fair Currency Act of 2007 (Introduced in Senate),S.796.IS, 110th Cong. (2007).
> 7. Fair urrency Act of 2007 (Introduced in House), H.R.782.IH, 110th Cong. (2007).
> 8. Currency Harmonization Initiative Through Neutralizing Action Act of 2005 (Introduced in House), H.R.321.IH, 110th Cong. (2007).
> 9. Strengthening America's Trade Laws Act (Introduced in Senate), S.364.IS 110th Cong. (2007).

Id.

subsidy to Chinese exporters and a tax on U.S. importers.[162] Furthermore, the bills' drafters believe that China's intervention in the currency markets violates the spirit and letter of the World Trade Organization.[163]

Article XXI of the General Agreement on Tariffs and Trade of 1994 (GATT) is commonly cited as the legal basis for the proposed tariffs.[164] In general, Article XXI allows a country to take necessary precautions, with respect to international trade, when issues of national security arise.[165] Specifically, Article XXI protects security interests with respect to "fissionable materials," arms trafficking, or those "taken in time of war or other emergency in international relations."[166] The congressional sponsors of these bills strongly advocate the position that protection of the U.S. manufacturing sector is essential to U.S. security interests and is a matter of national security.[167] However, it is unlikely that this congressional definition of security interests was contemplated by the drafters of the GATT.

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162. *See id.*

163. *See id.*

164. Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994) (codified as amended at 19 U.S.C. § 3501 (1994)) (adopting GATT 1994, 33 I.L.M. 1143, art. XXI (1994)). Article XXI is commonly refered to as the security provision. It states, in pertinent part:

> 1. Nothing in this Agreement shall be construed:
> (a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or
> (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
> (i) relating to fissionable materials or the materials from which they are derived;
> (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
> (iii) taken in time of war or other emergency in international relations; or
> (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

GATT 1994, art. XXI.

165. *See* GATT 1994, art. XXI(B).

166. *See* GATT 1994, art. XXI(B).

167. *See* list of pending congressional bills, *supra* note 161.

Additionally, an argument can be made that these legislative measures, if passed, are undertaken in a time of war[168] and are therefore consistent with Article XXI. Conversely, it could be said that the aim of the proposed congressional legislation is, at best, only tenuously connected with the global war on terror and is therefore probably inconsistent with the spirit of Article XXI. Despite this apparent inconsistency, at least one congressional bill[169] garnered the support of sixty-seven senators in a procedural vote, indicating popular support for the measure.[170]

It is unlikely that the WTO would support such a broad reading of Article XXI, and any piece of legislation based upon it. Additionally, if the United States were to impose such a protectionist measure upon China, it would run the risk of political fall-out with the international community. This reaction would likely take the form of retaliatory tariffs on U.S. goods, based upon means similar to those in Article XXI.

4. Section 201 Action

Another piece of legislation which has been passed to combat foreign nations' unfair trade practices is section 201 of the Trade Act of 1974.[171] Section 201 grants the U.S. President the authority to take emergency action to protect a domestic industry that has suffered substantial injury due to a sudden surge in foreign imports.[172] The authority to take such action is predicated on Article XIX of the GATT, which allows a nation to restrict imports of a product if its domestic industry is seriously injured or is threatened with serious injury.[173]

All section 201 actions begin with an ITC investigation of the extent to which an industry is injured by the import of a foreign product.[174] If the ITC determines that an imported product is "a substantial cause of serious injury," then the statute authorizes the President of the United States to take "all appropriate and feasible action within his power . . . [to]

168. The United States has been fighting the war on terror since the attacks of September 11, 2001.

169. This was the Schumer-Graham bill introduced in the 109th Congress. *See* S.295, 109th Cong. (2005).

170. Morrison, *supra* note 16.

171. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (1975) (Section 201) (codified as amended as 19 U.S.C. § 2251 (2007)).

172. Kelly Henry, Comment, *Is the United States the World's Dumping Ground for Steel? Recent Influxes in Steel Imports in the United States, the Effects, and the Possible Remedies*, 25 HOUS. J. INT'L L. 381, 401-02 (2003).

173. *See* GATT 1994, art. XIX.

174. 19 U.S.C. § 2251(a) (2007).

facilitate . . . a positive adjustment to import competition."[175] Such action may take the form of a duty, a tariff-rate quota, a quantitative restriction on the importation of the product, negotiations with the foreign country to adjust the export volume of the target product, initiating an international dialog to address the underlying causes of the import surge, or any other measures the President deems necessary.[176]

Historically, section 201 has been politically unpopular due to its protectionist nature and has often been reserved as a measure of last resort.[177] Section 201's heightened requirement of *substantial* injury has also been used as a barrier to encourage industry to seek less drastic forms of relief under the antidumping laws or the countervailing duty laws, both of which only require a showing of a material injury.[178] However, section 201 has been used as recently as 2002 by the Bush Administration,

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175. *See id.*

176. 19 U.S.C. § 2253(a)(3) (2007). The relevant portion of the statute is as follows:

> (3) The President may, for purposes of taking action under paragraph (1)—
> (A) proclaim an increase in, or the imposition of, any duty on the imported article;
> (B) proclaim a tariff-rate quota on the article;
> (C) proclaim a modification or imposition of any quantitative restriction on the importation of the article into the United States;
> (D) implement one or more appropriate adjustment measures, including the provision of trade adjustment assistance under chapter 2 19 U.S.C.S. §§ 2271 et seq.,
> (E) negotiate, conclude, and carry out agreements with foreign countries limiting the export from foreign countries and the import into the United States of such article;
> (F) proclaim procedures necessary to allocate among importers by the auction of import licenses quantities of the article that are permitted to be imported into the United States;
> (G) initiate international negotiations to address the underlying cause of the increase in imports of the article or otherwise to alleviate the injury or threat thereof;
> (H) submit to Congress legislative proposals to facilitate the efforts of the domestic industry to make a positive adjustment to import competition;
> (I) take any other action which may be taken by the President under the authority of law and which the President considers appropriate and feasible for purposes of paragraph (1); and
> (J) take any combination of actions listed in subparagraphs (A) through (I).

Id.

177. *See* COHEN ET AL., *supra* note 156, at 154-55.

178. *See id.*

signaling that perhaps the fear of losing American jobs is overtaking traditional American zeal for free trade.[179]

While section 201 is a powerful tool used to influence international trade, it seems to be simultaneously over inclusive and under-inclusive. The statute is over-inclusive because its punitive scope does not discriminate between products based on their country of origin. Thus, the consequences are felt by all countries which export a particular product to the United States not just the country at fault.[180] A 201 action could have unintended, negative political consequences for the international community. Given the increasing size of the global marketplace, it is becoming increasingly unlikely that a particular product is imported to the United States from only a single country. Correspondingly, it becomes more likely that a 201 action will affect at least one foreign nation's exporters who are merely innocent third parties and have not contributed to the domestic injury.

The statute is also under-inclusive in that it only protects against swells of imports of a specific product in an industry, but makes no mention of singling out all products from a certain nation. As mentioned above, the ITC is charged with investigating every industry which claims that a serious injury has been suffered by a surge in foreign imports. In order for a 201 action to be sustained against all Chinese products, the ITC must examine every industry in which Chinese goods are imported and determine that the domestic industry has suffered serious injury as a result of those goods. While current trade data is widely available to exhibit the effect of Chinese imports on certain U.S. industries,[181] the ITC's limited resources severely restrict it from conducting the exhaustive investigation necessary to reach a legitimate determination of serious injury. Apparently, suffering from the same deficiencies as the antidumping and countervailing duties laws, section 201 seems to be an inappropriate way to influence China to reform its currency policy.

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179. In March 2002, President Bush invoked section 201 to impose steel tariffs against foreign imports. Although the tariff was eventually appealed through the WTO and repealed, the move signaled President Bush's willingness to take such drastic actions. Trade Policy Review, *United States*, ¶¶ 29-34, WT/TPR?G/126 (Dec. 17, 2003), *available at* http://www.wto.org/english/tratop_e/tpr_e/S126-0_e.doc.

180. For example, if a U.S. industry were substantially harmed by the influx of a product from China, a section 201 action could impose a duty on that product regardless of its country of origin. Therefore, a Japanese manufacturer/exporter of the same product would share equally in the consequences with the Chinese manufacturers despite not being the cause of the injury.

181. *Industry and Job Trends of the U.S. and China*, http://www.uscc.gov/trade_data_and_analyses/industry_job_trends.php (listing graphs detailing US/China trade trends).

5. Section 301 Investigation

Section 301 of the Trade Act of 1974 gives the United States another tool to combat China's undesirable foreign trade practices. "Section 301 . . . is the principal statutory authority[182] under which the United States may impose trade sanctions against foreign countries that maintain acts, policies and practices that violate, or deny U.S. rights or benefits under, trade agreements, or are unjustifiable, unreasonable or discriminatory and burden or restrict U.S. commerce."[183] A section 301 investigation may be commenced by the U.S. Trade Representative (USTR) on its own initiative or on petition by any interested party.[184] Upon commencing an investigation, section 301 directs the USTR to seek consultation with the foreign government under investigation.[185] If the investigation involves an alleged violation of a trade agreement, such as a WTO agreement or the North American Free Trade Agreement (NAFTA), the USTR must use the dispute resolution procedure stipulated by that agreement.[186]

If the USTR finds that U.S. rights under a trade agreement are being infringed upon, or that a foreign government's actions or policies unjustifiably burden U.S. commerce, section 301 mandates retaliatory action[187] unless an exception applies.[188] However, if a foreign nation's

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182. Codified at 19 U.S.C. § 2411.

183. Jean Heilman Grier, Office of Chief Counsel for International Commerce, U.S. Department of Commerce, *Section 301 of the 1974 Trade Act* (2005), *available at* www.osec.doc.gov/ogc/occic/301.html.

184. 19 U.S.C. § 2412(a), (b).

185. 19 U.S.C. § 2413.

186. *Id.*

187. 19 U.S.C. § 2411(a).

188. Exceptions include:

> (A) [when] [t]he [WTO] has adopted a report, or a ruling issued under the formal dispute settlement proceeding provided under any other trade agreement finds, that—
> (i) the rights of the United States under a trade agreement are not being denied, or
> (ii) the act, policy, or practice—
> (I) is not a violation of, or inconsistent with, the rights of the United States, or
> (II) does not deny, nullify, or impair benefits to the United States under any trade agreement; or
> (B) the Trade Representative finds that—
> (i) the foreign country is taking satisfactory measures to grant the rights of the United States under a trade agreement,
> (ii) the foreign country has—
> (I) agreed to eliminate or phase out the act, policy, or practice, or

practices or policies are found to be merely unreasonable or discriminatory, then the USTR may impose discretionary sanctions.[189]

Much of the efficacy of a 301 action therefore lies in the USTR's initial characterization of the action or policy at issue. Practices or policies characterized as "unjustifiably burdensome" carry heavier consequences than those deemed to be "unreasonable and discriminatory" practices or policies. The label of unreasonable may be applied to an "act, policy, or practice, . . . [that] while not necessarily in violation of, or inconsistent with, the international legal rights of the United States, is otherwise unfair and inequitable."[190] These acts, policies, and practices include but are not limited to, those that deny fair and equitable opportunities for the establishment of an enterprise, constitute export targeting, or constitute a persistent pattern of conduct in violation of workers' human rights.[191]

In making a determination as to the reasonableness of China's currency policy, the USTR may scrutinize the policy on two fronts. First, China's stringent currency control system may be viewed as a substantial barrier to foreign companies doing business in China. However, the Chinese government has always applied the currency controls to all firms doing business in China. The currency control policies regulate all firms, both foreign and domestic, and thus, might not be viewed as treating one unfairly in comparison to the treatment of others.

Second, the undervaluation of the RMB could be considered to be an effective tax on U.S. imports, making U.S. goods more expensive in the Chinese market. If this analysis is applied, it would be possible for the USTR to find that U.S. goods are at a substantial disadvantage in China

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> (II) agreed to an imminent solution to the burden or restriction on United States commerce that is satisfactory to the Trade Representative,
> (iii) it is impossible for the foreign country to achieve the results described in clause (i) or (ii), as appropriate, but the foreign country agrees to provide to the United States compensatory trade benefits that are satisfactory to the Trade Representative,
> (iv) in extraordinary cases, where the taking of action under this subsection would have an adverse impact on the United States economy substantially out of proportion to the benefits of such action, taking into account the impact of not taking such action on the credibility of the provisions of this [chapter 19 U.S.C.S. §§ 2411 et seq.], or
> (v) the taking of action under this subsection would cause serious harm to the national security of the United States.

Id. ¶ 2411(a)(2).

189. *Id.* § 2411(b).

190. *Id.* § 2411(d)(3)(A).

191. *See id.* § 2411(d)(3)(B).

and therefore find that the underlying currency policies are unreasonable. The level of unreasonableness, however, must be directly proportional to the degree to which the USTR finds the RMB undervalued. If the USTR finds that the RMB is only slightly undervalued, the corresponding disadvantage of U.S. goods might not rise to a level sufficient to brand Chinese policy as unreasonable.

However, even if the USTR does find China's currency practices to be unreasonable, it would still have the discretion to take action or to do nothing at all.[192] This discretion will most likely reflect the goals and policies of the U.S. President because the USTR derives its powers directly from the Chief Executive's office.[193] Some analysts have speculated that the current USTR might curtail its discretion to impose sanctions on China because of other, indispensable political aspirations of the Bush administration.[194]

As with all political issues, China's currency and its effect on the U.S. economy has fluctuated in priority over time. In past years, the Bush administration has needed China's support to accomplish various foreign policy objectives such as anti-terrorism and anti-nuclear proliferation initiatives. In order to secure its cooperation, the Bush Administration has largely avoided direct confrontation with China over this controversial issue. However, recent changes in the U.S. political landscape might signal a new willingness on the part of the Bush Administration to raise the issue.[195] The increasingly aggressive rhetoric of the Bush Administration suggests that it will soon exert greater political pressure on China and take a more hard line approach to Chinese trade issues.

While a section 301 investigation has been politically undesirable in the past, many signs point to a change of U.S. sentiment and greater openness to the possibility. Shifting political power, changing trade policies, growing concern over the U.S. trade deficit, and the powerful lobby of the manufacturing sector have all played a part in focusing the nation's attention on China and solidifying its resolve to find a solution. It is possible that the protectionist elements in the United States will become so politically powerful that policymakers will pursue this course

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192. 19 U.S.C. § 2411(b).

193. *Id.*

194. Recently the Bush Administration has sought China's cooperation with several foreign policy initiatives including some delicate negotiations with North Korea over its nuclear proliferation agenda.

195. In the 2006 mid-term election the Democratic Party became the majority in both the House and the Senate. While previously enjoying the support of the Republican majority, President Bush now faces staunch political opposition from the new majority in Congress.

of action to appease the outcry. Because of its discretionary nature, a section 301 investigation may be a convenient way to single out unjustifiable and unreasonable Chinese policies and levy sanctions against them. However, the sanctions would have to be consistent with the political agenda of the sitting U.S. President for such action ever to be taken.

C. *Multilateral International Action*

Because the United States and China are both members of the WTO, the United States may choose to avail itself of the WTO dispute settlement process to resolve its trade conflicts with China.[196] If the United States were to initiate a complaint against China with the WTO, it would most likely base the complaint on Article XV of the GATT, which deals with exchange agreements between two or more countries.

Article XV of the GATT states, "Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund [IMF]."[197] Additionally, Article XV requires that WTO members "accept all findings of statistical and other facts presented by the [IMF] relating to foreign exchange, monetary reserves and balances of payments."[198] This means that should the United States file a WTO complaint against China, it must accept the IMF's determination as to whether taking action is appropriate.[199]

The IMF was created to promote international monetary cooperation by providing a forum for consultation and collaboration on international monetary problems, promoting exchange stability, maintaining orderly exchange arrangements among members, and avoiding competitive exchange depreciation.[200] The IMF regularly consults with its member

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196. The WTO Dispute Settlement Understanding (DSU) outlines the procedures for the dispute settlement process. The entire process is administered by the dispute settlement body (DSB). The DSU mandates that clashing Member States enter into consultations in good faith and proceed along a strict timeline. Should the consultations fail to produce an agreement, the DSB then creates a panel that will serve as an international tribunal. This panel is responsible for holding hearings and issuing a report on the dispute. Should a member disagree with a report, it may file an appeal with the appellate body (AB) which would then conduct its own hearings and issue its own report. Finally, the DSB then enforces compliance by the member. *See* J.G. MERRILLS, INTERNATIONAL DISPUTE SETTLEMENT 205-10, (3d ed., Cambridge Univ. Press 1998) (1984).

197. GATT art. XV.

198. *Id.*

199. *Id.*

200. IMF Articles, *supra* note 10, art. I.

states to conduct surveillance and "provides advice on issues ranging from the choice of exchange rate regime to ensuring consistency between [the] regime and . . . fiscal and monetary policies."[201]

In 2006, after its consultations with China, the IMF found that "from a global perspective, exchange rate flexibility would not only serve China's best interest, but would also help contribute to an orderly process for resolving global current account imbalances."[202] The IMF directors also noted that "greater exchange rate flexibility is needed to enable the [PBOC] to use its monetary policy instruments more effectively."[203] These statements are the latest installments of a rhetorical trend in which the IMF has urged China to reform its currency policies but refrained from setting a deadline to do so. To date, the IMF has largely allowed the Chinese government to determine the proper timing and scope of currency revaluation as long as the ostensible goal remains a fully floating exchange rate.

Should the United States allege that China has manipulated its exchange rate to gain an unfair advantage, the IMF would be called upon to conduct an investigation into the alleged currency manipulation. Article IV of the IMF Articles of Agreement states that members shall "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members,"[204] and under IMF surveillance procedures, a principal indicator of such manipulation is "protracted large-scale intervention in one direction in the exchange market."[205] The protracted purchases of billions of U.S. dollars by China

201. IMF Surveillance, A Factsheet, http://www.imf.md/imfsurveil.html (last visited Dec. 31, 2007).

202. Staff Report, *People's Republic of China: 2006 Article IV Consultation—Staff Report*, IMF Country Report No. 06/394 (Oct. 2006), *available at* http://www.imf.org/external/pubs/ft/scr/2006/cr06394.pdf.

203. IMF Executive Board Concludes 2006 Article IV Consultation with the People's Republic of China (Sept. 11, 2006), IMF Public Information Notice (PIN) No. 06/103, http://www.imf.org/external/np/sec/pn/2006/pn06103.htm.

204. IMF Articles, *supra* note 10, art. IV § 1(iii).

205. IMF, *Surveillance Over Exchange Rate Policies, Decision No. 5392 (77/63) (1977), compiled in selected Decisions and Selected Documents of the International Monetary Fund, Thirty First Issue*, 25,27 (Dec. 31, 2006), *available at* http://www.imf.org/external/pubs/ft/sd/2006/31s tissue.pdf.

> 2. In its surveillance of the observance by members of the principles set forth above, the Fund shall consider the following developments as among those which might indicate the need for discussion with a member:

would seem to fit this IMF definition of currency manipulation.

Upon a determination that such an intervention has occurred, the IMF would ask China to explain the motivation behind its actions. China would then be given the opportunity to explain its motives behind its currency market interventions and this explanation would be given the benefit of any reasonable doubt. Upon consideration of all available and relevant information regarding China's exchange rate policy, the IMF would then make an independent assessment as to whether China's representation was correct. On that basis, the IMF would make its determination as to whether the actions in question were being taken for one of the prohibited purposes identified in Article IV.[206]

China's likely defense of its interventions in the currency markets would be that it has maintained the same exchange rate for over a decade and, like many other countries, has bought U.S. treasury securities for even longer. China would point to the consistency and longevity of its currency practices to convince the IMF that no currency manipulation has occurred. While it is not clear how convincing this "business as usual" defense would be in the eyes of the IMF, it is equally unclear if the IMF would side with the United States on this issue. As previously noted, the IMF has been wary of giving China any ultimatums with respect to its currency revaluation. The IMF has not even attempted to promulgate a timeline for RMB revaluation, choosing instead to allow China the freedom to move

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> (i) protracted large-scale intervention in one direction in the exchange market;
> (ii) an unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term official or quasi-official lending, for balance of payments purposes;
> (iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or
> (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;
> (iv) the pursuit, for balance of payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows;
> (v) behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements; and
> (vi) unsustainable flows of private capital.

Id. at 26-27.

206. IMF, *Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework*, June 28, 2006, at 16, *available at* http://www.imf.org/external/np/pp/eng/2006/062806.pdf.

at its own pace. If the United States pursued a case against China by alleging currency manipulation, and the IMF did not produce an affirmative finding, the United States would be compelled to accept this finding as the ultimate resolution on the issue and no further international action could be taken. Given this state of affairs, it would not be in U.S. best interests to rely on the IMF for an affirmative finding of currency manipulation, even though the United States seems to have a prima facia case for currency manipulation.

On February 2, 2007, the United States lodged a formal complaint against China with the WTO.[207] The complaint specifically alleged that China uses its tax policies to illegally subsidize Chinese exporting firms, giving them a global, competitive advantage.[208] While not specifically addressing Chinese currency policy as a form of subsidy, the outcome of the current WTO challenge could serve as a barometer for the likelihood of a successful challenge on that issue.

Critics of Chinese currency policy have been calling on the Bush Administration to initiate a WTO complaint against China for some time.[209] Prior to this time, however, the Bush Administration has maintained that a successful WTO challenge was doubtful and would be "more damaging than helpful" for the above stated reasons.[210] This latest move is perhaps an attempt to focus the WTO on a relevant "gateway issue," which if successful, could open the door to a direct challenge to China's currency policy as an export subsidy and also as a form of currency manipulation.

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207. Associated Press, *U.S. Starts Legal Action Against China at WTO Over Subsidies*, INT'L HERALD TRIB., Feb. 2, 2007, *available at* http://www.iht.com/bin/print.php?id=4449502.

208. Request for Consultations by the United States, *China—Certain Measures Granting Refunds, Reductions or Exemptions From Taxes and Other Payments*, WT/DS358/1 (Feb. 7, 2007), *available at* http://www.worldtradelaw. net/clds358-1(cr).pdf.

209. In 2004 the Bush Administration rejected two requests: one filed by the China Currency Coalition (a group of U.S. industrial, service, agricultural, and labor organizations) and one filed by 30 members of Congress. Both petitions sought to have the United States bring a case before the WTO challenging China's currency policy. Morrison & Labonte, *supra* note 3, at CRS-38.

210. Neena Moorjmi, Statement from USTR Spokesperson Regarding a Section 301 Petition on China's Currency Regime (Nov. 12, 2007), *available at* http://www.ustr.gov/Document_Library/ Spokesperson_Statements/Statement_from_USTR_Spokesperson_Neena_Moorjani_Regarding _a_Section_301_Petition_on_Chinas_Currency_Regime.html?ht=.

IV. CONCLUSION

When asked whether the United States would ultimately regret pushing China to revalue the RMB, Nouriel Roubini, a professor of economics and international business at New York University, commented, "the first rule of good manners—and finance as well—is that you should not bite the hand that feeds you."[211] With the recent flurry of proposed legislation, fueled by the protectionist outcries of the manufacturing sector, one cannot help but wonder whether this entire issue is nothing more than a creature of popular politics. Almost daily the mainstream media features stories of American workers who have lost jobs and blame the upheaval in their lives on "low cost Chinese goods." While the loss of American jobs is always unfortunate and regrettable, a closer look at the facts shows a much more complex story than many people are otherwise led to believe.

American manufacturing is dying. There is a long-term trend, even more pronounced than the Chinese currency issue, which shows U.S. production is shifting away from manufacturing[212] and toward the service sector.[213] Americans, as a whole, are becoming better suited for producing knowledge and technology intensive goods while nations like China are becoming increasingly efficient at producing labor intensive goods. Because of growing international trade, over time this trend of production specialization will continue regardless of China's currency policy.[214] New reactionary policies should not be applied willy nilly, based on the desires of a relatively small, and shrinking, segment of the U.S. economy. Rather, policymakers ought to look to the future to decide which direction the United States should pursue, and what steps are necessary to realize those goals.

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211. Blustein, *supra* note 14.

212. U.S. employment in manufacturing has fallen from 31.8% in 1960 to 22.4% in 1980 to 11% by the end of 2006. Morrison & Labonte, *supra* note 2, at CRS-3 n.2.

213. *See* Craig Elwell, *Deindustrialization of the U.S. Economy: The Roles of Trade, Productivity, and Recession*, CRS Report RL3250, Apr. 15, 2004, *available at* http://opencrs.cdt.org/rpts/RL32350_20040415.pdf. *See also* Robert Rowthorn & Ramana Rasmaswamy, *Deindustrialization: Its Causes and Implications*, 10 ECON. ISSUES (1997), http://www.imf.org/EXTERNAL/PUBS/FT/ISSUES10/INDEX.HTM.

214. "The decline in manufacturing employment is not unique to the United States. According to a study done by Alliance Capital Management, manufacturing employment among the world's 20 largest economies declined by 22 million jobs between 1995 and 2002." Wayne M. Morrison & Marc Labonte, *China's Currency: Economic Issues and Options for U.S. Trade Policy*, CRS Report for Congress RL32165 (Oct. 2, 2006), at CRS-27, http://fpc.state.gov/documents/organization/74900.pdf.

Still, much of the U.S. public refuses to embrace the changing nature of our global economy and American workers' new roles in it. Instead many "pro-American" interest groups lose themselves in the nostalgia of days gone by when American factories thrived, American cars were king, and a bottle of Coca-Cola cost a nickel. In an effort to return to the good-ole-days, they lobby Congress to enact rash legislation, garner media attention to sell their sympathetic plight, and interject a high level of emotion into what ought to be a rational, economic discussion. Hypocritically, these are often the same people who demand low cost goods at Wal Mart, and enjoy the benefits of home ownership via a mortgage at historically low interest rates. However, the U.S. public cannot have its cake and eat it too. Favorable U.S. interest rates and access to low cost import goods would be seriously undermined by a major alteration to China's currency policy.

The solution to the loss of American jobs is not to berate China over its currency valuation strategies, but to focus on creating new jobs that are sustainable and competitive in the new global economy, and to re-educate the American population to embrace a more savings oriented lifestyle. To do this, American workers will need to learn new skills, enter new industries, and blaze new economic trails. All Americans will need to reexamine their own personal financial habits and evolve to meet the demands of changing domestic and foreign economies. The necessary adjustment may seem daunting at first, but in reality, it is a challenge that Americans have always overcome. Perseverance, creativity, and common sense are skills that every American, blue collar or otherwise, has always possessed.