Exchanging Approaches: Evaluating Methods to Counter Chinese Currency Undervaluation

by

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Graduate Department of Law
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Abstract

I evaluate four possible approaches the United States may take to address China’s practice of undervaluing the renminbi: 1) a challenge under Article XV of the GATT and the associated IMF provisions; 2) countervailing duties; 3) antidumping measures; and 4) safeguard measures. I conclude that the first three approaches are unlikely to succeed; there are a number of legal and political obstacles to the pursuit of these remedies. While the current WTO safeguards regime is likely insufficient, a new safeguards regime can—and should—be developed. I review and critique Dani Rodrik’s proposal for a new safeguards regime and set out my own basic blueprint for a significantly expanded safeguards regime, emphasizing that flexibility in the realm of international trade law would help to secure overall stability in international trade itself. In order to be effective shock absorbers, safeguards must become far more flexible.
Acknowledgments

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# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstract</td>
<td>ii</td>
</tr>
<tr>
<td>Acknowledgments</td>
<td>iii</td>
</tr>
<tr>
<td>I. Introduction</td>
<td>1</td>
</tr>
<tr>
<td>II. Is China’s currency undervalued?</td>
<td>3</td>
</tr>
<tr>
<td>III. What are the effects of Chinese currency undervaluation?</td>
<td>7</td>
</tr>
<tr>
<td>IV. What are the potential legal approaches the United States can take to combat Chinese currency undervaluation?</td>
<td>13</td>
</tr>
<tr>
<td>A. Article XV of the GATT and IMF Articles</td>
<td>14</td>
</tr>
<tr>
<td>B. Countervailing Duties</td>
<td>23</td>
</tr>
<tr>
<td>Red Light Approach</td>
<td>28</td>
</tr>
<tr>
<td>Yellow Light Approach</td>
<td>29</td>
</tr>
<tr>
<td>C. Antidumping Provisions</td>
<td>32</td>
</tr>
<tr>
<td>D. Safeguards</td>
<td>35</td>
</tr>
<tr>
<td>Relevant Decisions in Cases Involving Safeguards</td>
<td>39</td>
</tr>
<tr>
<td>Issues with the Current WTO Safeguards Regime</td>
<td>43</td>
</tr>
<tr>
<td>V. How would a new safeguards regime address concerns relating to currency undervaluation?</td>
<td>47</td>
</tr>
<tr>
<td>Rationales for the Existence of the WTO Safeguards Regime</td>
<td>47</td>
</tr>
<tr>
<td>Overview and Critique of Rodrik’s Proposal</td>
<td>53</td>
</tr>
<tr>
<td>Basic Blueprint for a New and Expanded Safeguards Regime</td>
<td>61</td>
</tr>
<tr>
<td>Efficacy of New Safeguards Regime in the Context of Renminbi Undervaluation</td>
<td>67</td>
</tr>
<tr>
<td>VI. Conclusion</td>
<td>70</td>
</tr>
<tr>
<td>Bibliography</td>
<td>75</td>
</tr>
</tbody>
</table>
I. Introduction

China and the United States (“US”) have an extremely complex economic and political relationship. The two countries are so interdependent that neither country can afford to make any moves that would significantly harm the other. In fact, paradoxically, the economies of both China and the US are structured in such a way that each benefits from an increase in the other’s strength. As such, it is problematic to view China and the US as being engaged in true economic warfare.

The most important component of this relationship between China and the US is in the arena of international trade. Exchange rate policy plays a vital role in this context, as it has significant effects on foreign trade. Accusations of Chinese currency manipulation have been commonplace for well over a decade, and have been increasing in frequency since the beginning of the global economic meltdown. As the US has lost its comparative advantage vis-à-vis China in industries such as textile production, consumer electronics, and automobile manufacturing, politicians, journalists, and scholars—amongst others—have sought to blame China for America’s demise in traditional “smokestack” sectors. Politicians from both main American political parties, political commentators, and various interest groups have engaged in

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2 Ibid.
3 Ibid at 151-152.
4 Ibid at 151-153.
5 Ibid.
“China-bashing” and have called on the US to confront China on the currency issue.\textsuperscript{10} This paper examines four possible approaches that the US may take to combat China’s purported currency undervaluation: 1) a challenge under Article XV of the General Agreement on Tariffs and Trade (“GATT”) and the associated International Monetary Fund (“IMF”) provisions relating to currency manipulation;\textsuperscript{11} 2) the implementation of countervailing duties as a response to Chinese currency practice viewed as an export subsidy;\textsuperscript{12} 3) an argument that the antidumping provisions of the GATT may prohibit China’s actions;\textsuperscript{13} and 4) a response under the GATT emphasizing the use of safeguard remedies.\textsuperscript{14}

I argue that the US would be unlikely to succeed with a challenge against Chinese currency practice through the lodging of a complaint on the basis of currency manipulation (under Article XV of the GATT and the related IMF provisions), through the implementation of a countervailing duty in response to claiming that Chinese currency undervaluation constitutes a countervailable export subsidy, or through the attempted use of antidumping provisions. Moreover, I assert that none of these directly confrontational approaches—even if they were likely to succeed from a legal standpoint—would be beneficial to the US from a political economy perspective. I argue that pursuing safeguard remedies would be in America’s best interests, but that in order to succeed, this strategy would likely require the US to advocate for a reimagining of the

\textsuperscript{9} “The China-bashing syndrome: Both parties are cranking up their rhetoric against the world’s second-largest economy”, The Economist (14 July 2012) online: Economist.com <http://www.economist.com/node/21558581>.
\textsuperscript{10} Ibid.
\textsuperscript{12} Ibid at 34-35 and 392-399.
GATT/World Trade Organization ("WTO") safeguards regime. I review and critique a proposal for a new safeguards regime by Dani Rodrik, a leading political economist who has recently been named the Albert O. Hirschman Professor in the School of Social Science at the Institute for Advanced Study, and I set out my own basic blueprint for a significantly expanded safeguards regime.

II. Is China’s currency undervalued?

Prior to evaluating the legal and policy considerations relating to potential challenges against Chinese currency practices, it is necessary to first examine the foundational claims against China. How is China treating its currency and does this constitute undervaluation?

In order to answer these questions, a brief summary of Chinese currency history is necessary. The renminbi (referred to as “RMB” on markets)—the primary unit of which is the yuan—is the official name of China’s currency. From 1994 until July 2005,16 the renminbi was pegged to the value of the US dollar at a rate of 8.28 RMB to the dollar.17 In the midst of the Asian financial crisis of 1998-2000, politicians and central bankers in the US, Europe, and Japan were concerned that China would devalue the renminbi in an attempt to stabilize its own economy by attracting foreign

15 Liew & Harry, supra note 6 at 2.
investment and ensuring that exports would remain cheap for foreign buyers.\textsuperscript{18} Although this may have been beneficial to China, at least in the short term, Westerners feared that the trade-distorting effects stemming from such a move would jeopardize the economies of China’s neighbours, on whom the West relied to provide a large and prosperous market for Western products.\textsuperscript{19} Amid significant pressure from the US, China did not devalue the renminbi at the time of the Asian financial crisis.\textsuperscript{20} However, Western fears about Chinese currency devaluation were never fully allayed.

As business and finance professors Leong Liew and Harry Wu state, “Many policymakers in the US hold China largely responsible for the perceived US deindustrialization, blaming what they call China’s ‘unfair trade practices’.”\textsuperscript{21} While many Americans, fearful of losing the ability to domestically produce advanced machinery and vehicles, view this as a security issue, Liew and Wu argue that “[much] of the so-called deindustrialization in the US is simply an outcome of economic development, where the structure of the economy shifts over time from concentration in agriculture, to manufacturing and later to services.”\textsuperscript{22} It also reflects the fact that the comparative advantage in these production areas has shifted from developed countries like the US to low-cost countries like China.\textsuperscript{23}

After years of pressure from developed countries, the Chinese government ended the pegged exchange rate system for the renminbi on July 21, 2005.\textsuperscript{24} However, the renminbi was not allowed to float freely on currency markets; the pegged system

\textsuperscript{18} Liew & Wu, supra note 6 at 3.
\textsuperscript{19} Ibid.
\textsuperscript{20} Ibid at 21.
\textsuperscript{21} Ibid at 10.
\textsuperscript{22} Ibid.
\textsuperscript{23} Ibid.
\textsuperscript{24} Ibid at 21.
was replaced by a managed floating exchange rate system referenced to a basket of currencies, which immediately revalued the renminbi to 8.11 RMB per US dollar.\textsuperscript{25}

Because of this controlled floating exchange rate, the renminbi appreciated—though at a cautious pace—\textit{vis-à-vis} the US dollar between 2005 and 2008.\textsuperscript{26} However, with the onset of the global financial crisis in 2008, the renminbi was once more (unofficially) pegged to the US dollar.\textsuperscript{27} Nevertheless, as noted in a recent US Department of Treasury report, there have been some recent positive developments—from an American perspective—on the Chinese currency front:

After a period of roughly two years in which the Chinese renminbi...was pegged to the U.S. dollar, Chinese authorities decided in June 2010 to allow the exchange rate to appreciate in response to market forces. Since the June announcement, the RMB has appreciated by a total of 5.1 percent against the dollar through the end of April 2011, or at a rate of approximately 6 percent per year in nominal terms. Because inflation in China is higher than it is in the United States, the RMB has been appreciating more rapidly against the dollar on a real, inflation-adjusted basis, at a rate of around 9 percent per year. A more rapid pace of nominal appreciation would enable China to achieve the needed adjustment in the real value of its currency, while simultaneously reducing inflationary pressures in its economy.\textsuperscript{28}

Despite these developments, the renminbi is still widely considered to be undervalued.\textsuperscript{29} However, critics of Chinese currency policy differ on their evaluations of the margin by which the renminbi is undervalued; estimates range from an

\textsuperscript{25} \textit{Ibid}.
\textsuperscript{28} \textit{Ibid} at 235.
undervaluation of five percent to 40 percent relative to the US dollar. In 2011, the IMF considered the renminbi to be undervalued in the range of between three and 23 percent “depending on the methodology used to calculate the theoretical value” against a basket of currencies.

Because of the number of variables involved, and because of the necessary emphasis placed on purchasing power parity, which is difficult to evaluate in and of itself, it is nearly impossible to calculate a precise degree of currency undervaluation. Some commentators argue that the entire discussion about Chinese currency undervaluation is unwarranted; this view is reflected in a 2010 editorial published by the Wall Street Journal, a publication that is “no friend of Chinese economic policy.”

At the core of this argument is a basic misunderstanding of monetary policy. There is no free market in currencies, as there is in wheat or bananas. Currencies trade in global markets, but their supply is controlled by a cartel of central banks, which have a monopoly on money creation. The Federal Reserve controls the global supply of dollars and thus has far more influence over the greenback’s value than any other single actor.

A fixed exchange rate is also not some nefarious economic practice rare in human affairs. From the end of World War II through the early 1970s, most global currency rates were fixed under the Bretton-Woods monetary system created by Lord Keynes and Harry Dexter White. That system fell apart with the U.S.-inspired inflation of the 1970s, and much of the world moved to "floating rates."

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32 Note that the renminbi’s value has been appreciating recently, meaning that some of these estimates may no longer be accurate. See: Kenneth Rapoza, “China Currency To Gain Against Dollar This Year” Forbes (6 January 2013), online: Forbes.com <http://www.forbes.com/sites/kenrapoza/2013/01/06/china-currency-to-gain-against-dollar-this-year/>. However, for the purpose of this paper, it is sufficient to say that the renminbi is undervalued to some extent.  
33 Stalker, supra note 29 at 89.  
But numerous countries continue to peg their currencies to the dollar, and with the establishment of the euro most of Europe decided to move to a fixed-rate system. The reason isn’t to get some trade advantage against their neighbors but to gain the economic benefits of stable exchange rates—and in some cases a more stable monetary policy. A stable exchange rate eliminates a major source of uncertainty for investment decisions and trade and capital flows.35

Without entering into a debate about the virtues of a pegged currency, it is nevertheless clear that by not allowing the renminbi to float freely on currency markets, the Chinese government is holding its value at some amount below what it would otherwise be.36 For the purposes of this paper, it is therefore sufficient to assume that—to some degree—China is intentionally undervaluing its currency, rendering its exports cheaper and imports dearer.37

III. What are the effects of Chinese currency undervaluation?

A number of different economic models have been developed in attempts to determine the purported effects stemming from China’s policy of maintaining an undervalued currency.38 Unfortunately, there has been very little comprehensive empirical analysis undertaken showing clear support for any of the models developed to date.39

36 Tselichtchev, supra note 1 at 153-154.
37 The degree to which China is undervaluing its currency, which as discussed is very difficult to calculate, is not particularly relevant to this discussion, as my primary goal is to examine possible approaches for countering policies of intentional currency undervaluation.
38 Staiger & Sykes, supra note 17 at 591.
39 Ibid.
Intuitively, an undervalued renminbi makes Chinese-made goods more attractive to foreign buyers, which is beneficial to Chinese exporters.\textsuperscript{40} Consumers in foreign countries can buy tradable goods from China at a relatively cheap rate. However, an undervalued renminbi also has the effect of making imports into China more expensive for Chinese consumers, hurting foreign firms’ prospects of selling goods in the Chinese market.\textsuperscript{41} Chinese consumers will be incentivized to limit their spending on foreign-produced and -sourced goods, as their buying power will be limited. They will instead likely purchase Chinese goods (most likely of the type that are not sold through international markets) and/or save their money.\textsuperscript{42} This is entirely rational behaviour—why spend (particularly on imported goods) when the value of that money is being held artificially low?

There are a number of issues to consider here. As Tselichtchev states, by undervaluing the renminbi, “Chinese authorities send a clear message to Western manufacturers: 'Why bother exporting? Better come here and produce in China!''\textsuperscript{43} Left with very few alternatives if they want access to the huge Chinese market, an increasing number of Western companies opt to produce in China rather than export to the Chinese market, further increasing China’s production and export power.\textsuperscript{44} Of course, establishing local production facilities is no guarantee of strong sales within China. Despite accession to international agreements on the protection of trademarks, copyrights, and patents, counterfeits are commonplace in China. With lax enforcement of intellectual property laws, many Chinese consumers—and visitors to China—opt to purchase much cheaper “knockoffs,” which are in some cases produced by the same

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\textsuperscript{40} Rodrik, supra note 14 at 276.
\textsuperscript{41} Staiger & Sykes, supra note 17 at 587-588.
\textsuperscript{42} Ibid.
\textsuperscript{43} Tselichtchev, supra note 1 at 154.
\textsuperscript{44} Ibid.
workers and in the same facilities as the legitimate products. Easy access to locally produced counterfeit goods—many of which are of at least passable quality—may mean that the typical Chinese consumer is not as negatively impacted by a policy of currency undervaluation as one might expect. In 2005, it was “estimated that counterfeits [constituted] between 15 and 20 percent of all products made in China” and accounted for roughly eight percent of China’s gross domestic product. American industry analysts estimated that counterfeit goods cost US firms over USD$2.3 billion in lost sales in 2005, though this conclusion is debatable, as it erroneously assumes that consumers would have purchased the genuine articles at higher prices but for the availability of counterfeits. Regardless, it would seem that market access in China is a significant issue for US firms; renminbi undervaluation means that American companies must set up shop in China if they wish to effectively sell their products to Chinese consumers, but establishing production facilities in China is no guarantee that substantial (legitimate) sales gains will be made.

The upshot of this is a rather complex balance-of-payments (“BoP”) relationship between China and the US. BoP accounts for all monetary transactions between a particular country and foreign countries. BoP is comprised of two major components: current account and capital account. The current account balance reflects a country’s net income and is “the sum of net exports of goods, services, net income, and net current

46 Ibid.
47 MIT Center for International Studies, Foreign Policy Index: China, online: Massachusetts Institute of Technology <http://web.mit.edu/cis/fpi_china.html>.
48 Ibid.
49 Ibid.
51 Ibid.
transfers.” As Grant Bishop, a Canadian legal scholar and a former economic researcher with the World Bank, states, “Current account deficits represent net borrowing by an economy from abroad, typically in order to finance imports in excess of exports (a negative trade balance) but also to finance net investment payments and current transfers.” Conversely, a current account surplus would “represent net lending to the rest of the world.”

A country's capital account reflects the net change in ownership and is calculated by subtracting the change in domestic ownership of foreign assets from the change in foreign ownership of domestic assets. The current account balance often reflects changes in a state’s capital account, as “[a] country running a current account surplus is acquiring foreign assets while a deficit country is incurring liabilities.”

As Bishop states, current account balance has important consequences with respect to a country's exchange rate. He argues:

Absent intervention to sustain a currency’s value, a persistent current account surplus should put upwards pressure on the domestic currency as foreigners demand more exports than the domestic economy imports. However, as Chinese policy...has demonstrated, a country can neutralize such appreciative pressures by "sterilizing" these foreign capital inflows—that is, increasing the domestic money supply and exchanging this additional currency for foreign currency. The accumulation of reserves of foreign currency (or, more precisely, financial assets denominated in foreign currency) is the consequence of such sterilization.

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54 Ibid.
55 Danby, supra note 50.
56 Bishop, supra note 53 at 8.
57 Ibid.
58 Ibid at 8-9.
As Rodrik observes, China “has to buy dollars to prevent its currency from appreciating,” leading it to “accumulate more than $2 trillion in reserves—low-return US Treasury bills and other assets for which the country has no conceivable use.” Bishop argues that such a “sterilization through foreign exchange intervention comes at the risk of heightened domestic inflation as more currency ‘chases’ the economy’s goods.”

China exports much more than it imports, especially vis-à-vis the US. In 2011, China imported American goods and services worth a total of USD$129 billion, whereas the US imported Chinese goods and services worth a total of USD$411 billion, meaning that the Chinese trade surplus vis-à-vis the US was USD$282 billion that year alone.

The Chinese model for growth has focused on “rapid structural change,” with a primary emphasis on promoting industrialization, particularly with respect to tradable manufactured goods. Historically, China was able to follow this growth strategy without producing a trade imbalance, as an increased supply of manufactured goods was matched by growing demand amongst Chinese consumers for such goods. Tariffs, subsidies, and other trade restrictions ensured relatively balanced trade volumes.

However, in order to gain membership in the WTO, China eliminated many trade-restricting (but also trade-balancing) measures, such as subsidies and domestic-processing requirements. But, as Rodrik states, China “wasn’t about to give up on its

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59 Rodrik, supra note 14 at 277.
60 Ibid.
61 Bishop, supra note 53 at 9.
62 Office of the United States Trade Representative, China, online: Office of the United States Trade Representative <http://www.ustr.gov/countries-regions/china>.
63 Ibid.
64 Rodrik, supra note 14 at 275.
65 Ibid.
66 Ibid.
67 Ibid at 275-276.
68 Ibid at 276.
growth strategy,” so in order “[t]o compensate for the decline in protection and direct support to manufacturing, it allowed the renminbi to become increasingly undervalued.” Rodrik argues, “A cheap domestic currency has the same economic effects as a subsidy on exports combined with a tax on imports,” which “necessarily generates a trade surplus.” Indeed, China’s trade surplus began to grow substantially around the same time it officially joined the WTO in December 2001. Given the current international trade law context, Rodrik explains China’s strong opposition to any pressure to allow for appreciation of the renminbi:

Such a policy would help reduce global imbalances, but it would also threaten China’s economic growth. My own research suggests that China’s growth might be reduced by 2 percentage points or more if the renminbi is allowed to appreciate sufficiently to eliminate its undervaluation. A reduction of this magnitude would in turn bring growth below the 8 percent threshold that the Chinese leadership believes is necessary for the economy to generate sufficient employment and avoid social strife.

Rodrik’s argument is almost entirely accurate. However, his characterization of the renminbi’s undervaluation acting as both an export subsidy and an import tax is not precisely correct. Anton Korinek of the University of Maryland and Luis Serven of the World Bank agree with scholars like Rodrik that an undervalued currency can have trade-restrictive effects, but they conclude that “[a]n undervalued currency simultaneously encourages the domestic production of tradables, similar to a

\begin{itemize}
\item [69] *Ibid.*
\item [70] *Ibid.*
\item [71] *Ibid* [emphasis in original].
\item [72] *Ibid.*
\item [73] *Ibid.*
\item [74] *Ibid.*
\item [75] *Ibid.*
\end{itemize}
production or export subsidy, and discourages the domestic consumption of tradables, similar to a consumption tax or import tariff.”77 The distinction here may appear to be insignificant, but it is important; an undervalued currency discourages the domestic consumption of all tradable goods—not merely imported tradable goods.78 (In this sense, the addition of the words “or import tariff” on the part of Korinek and Serven is misleading.) As Bishop explains:

[T]he current account surplus functions as net loans to foreigners to purchase these domestically-produced tradable goods and sterilization preserves the exchange rate despite the heightened external demand. The consequent undervaluation increases the domestic price of tradable goods relative to non-tradable goods and crowds out domestic consumption... Since exports increase and domestic consumption of tradable goods (and consequently domestic consumption overall) decreases...the result is an exaggerated current account balance and a higher savings rate.79

IV. What are the potential legal approaches the United States can take to combat Chinese currency undervaluation?

While attempting to adhere to the black letter of the law with respect to being a member of the WTO, China has been reluctant to abandon its growth strategy of encouraging increased industrialization and technological development. Although currency undervaluation is not as blatantly in breach of international trade law as other policies aimed at maximizing industrial growth (such as explicit tariffs, subsidies, domestic-processing requirements, etc.), arguments can be made that a number of different remedies should be made available to the US and to other countries suffering as a result of the effects of Chinese currency undervaluation.

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77 Ibid.
78 Bishop, supra note 53 at 16 & 18.
79 Ibid at 16.
A. Article XV of the GATT and IMF Articles

Article XV:4 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.” The interpretive note associated with Article XV explains that “‘frustrate’ is intended to indicate...that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article.”

Article XV:2 of the GATT states that deference shall be given to “the determination of the [IMF] as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund.” The IMF provisions “suggest that, where measures have been taken with respect to exchange controls or restrictions...the intent of the GATT is not to impose disciplines beyond those required by the IMF.” This is the case “even if such measures would otherwise be considered trade restrictions because of their effect on import and export transactions.” However, as Prof. Michael Trebilcock of the University of Toronto, Prof. Robert Howse of New York University, and Antonia Eliason, a corporate finance lawyer, argue, the GATT does not cede jurisdiction to the IMF entirely. After all, if an action is deemed to be inconsistent with the relevant IMF Articles, the “safe haven’ of Article XV disappears and the measure may well then fall afoil of a provision

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82 GATT 1947, supra note 80 at Article XV:2.
83 Trebilcock, Howse & Eliason, supra note 11 at 233-234 [emphasis in original].
84 Ibid.
85 Ibid at 234.
of the GATT,”86 meaning that a country may be on the receiving end of punishment from both the IMF and the WTO. However, with the WTO acting as a “residual enforcer for the IMF,”87 it is unlikely that a country’s actions with respect to exchange rates would be found to meet the standards set by the IMF Agreement but be in breach of the GATT.

IMF Agreement Article IV, Section 1(iii), states that IMF member countries shall not “manipulate 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.”88 As Vera Thorstensen, Daniel Ramon, and Carolina Muller of the Center on Global Trade state, “Article XV of the GATT and Article IV of the IMF...thus [formed] the primary bond between [the GATT and the IMF], guaranteeing that exchange rates would not be of concern to international trade as long as the fixed exchange rate system was in place.”89 However, after the end of the Bretton Woods fixed exchange rate system in the 1970s and “the IMF’s loosened control over exchange rates,”90 Article IV of the IMF “gradually lost its focus on exchange rates, as well as its central place in the Fund’s objectives, breaking the link between the two institutions.”91

Article IV of the IMF was originally inspired by the notion that “if no country was allowed to devalue its currency to gain a commercial advantage over its neighbor, the balance of payments of all countries would be protected and the system would not fall prey to a ‘race to the bottom.'”92 A par-value system—based on the convertibility of US

86 Ibid.
87 Ibid.
88 Articles of Agreement of the International Monetary Fund, 22 July 1944, 2 UNTS 39, 60 US Stat 1401 (entered into force 27 December 1945) at Article IV, Section 1(iii).
90 Ibid.
91 Ibid.
92 Ibid at 357.
dollars to gold—ensured exchange stability.\textsuperscript{93} All states were required to maintain this par value within one percent of the value determined by the IMF—by the intervention of their central banks if necessary.\textsuperscript{94} However, as a result of the US government’s inability to maintain the gold parity in light of the costly Vietnam War,\textsuperscript{95} the IMF moved toward a floating-currency system. After a series of negotiations, the “1997 Decision” was adopted, allowing IMF members to choose from a set of exchange rate policies: “allowing the currency to float freely, pegging it to another currency or basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.”\textsuperscript{96} Without the ability to determine par values for currency exchange rates,\textsuperscript{97} the IMF “concentrated its efforts [on] guaranteeing the financial health of a floating exchange rate system”\textsuperscript{98} by employing a surveillance mechanism in order to prevent countries from “[reverting] to competitive exchange rate devaluation.”\textsuperscript{99} The surveillance mechanism has changed since 1977, moving away from a system of firm surveillance over exchange rate policies.\textsuperscript{100}

In June 2012, the Executive Board of the IMF adopted the “Decision on Bilateral and Multilateral Surveillance” (“Integrated Surveillance Decision”), which builds on the 2007 Decision entitled “Bilateral Surveillance over Members’ Policies,”\textsuperscript{101} in order to

\begin{footnotesize}
\begin{enumerate}
\item Ibid.
\item Ibid.
\item Ibid at 360.
\item Ibid.
\item Ibid at 361.
\item Ibid at 363.
\item Ibid at 362.
\item Ibid at 361-362.
\end{enumerate}
\end{footnotesize}
clarify and strengthen the legal framework in place for surveillance.\textsuperscript{102} The Integrated Surveillance Decision sets out five principles:

A. A member 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.

B. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterized inter alia by disruptive short-term movements in the exchange rate of its currency.

C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

D. A member should avoid exchange rate policies that result in balance of payments instability.

E. A member should seek to avoid domestic economic and financial policies that give rise to domestic instability.\textsuperscript{103}

At first glance, this may seem straightforward and may appear to support a US claim that China is manipulating its currency, especially in light of BoP concerns involving China and the US. However, it is important to consider other aspects of the Integrated Surveillance Decision in order to glean a more accurate understanding of the surveillance and enforcement environment.

For instance, s. 20 of the Integrated Surveillance Decision states:

In applying these Principles, the Fund will pay due regard to the circumstances of members. Members are presumed to be implementing policies that are consistent with the Principles. When, in the context of surveillance, a question arises as to whether a particular member is implementing policies consistent with the Principles, the Fund will give the member the benefit of any reasonable doubt, including with respect to an assessment of fundamental exchange rate misalignment. In circumstances


\textsuperscript{103} IMF, \textit{Integrated Surveillance Decision, supra} note 101 at 21.
where the Fund has determined that a member is implementing policies that are not consistent with these Principles and is informing the member as to what policy adjustments should be made to address this situation, the Fund will take into consideration the disruptive impact that excessively rapid adjustment would have on the member’s economy.104

Although Principle A reflects an obligation—in fact, it is a simple restatement of the obligation contained in Article IV, Section 1(iii), of the IMF Agreement—it is made clear in s. 21 that "Principles B through E constitute recommendations rather than obligations of members."105 Moreover, it is explained that “[a] determination by the Fund that a member is not following one of these recommendations would not create a presumption that that member is in breach of its obligations under Article IV, Section 1.”106 Similarly deferential language appears in s. 22, which states:

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 would require thorough review and might indicate the need for discussion with a member:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, 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;

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104 Ibid at 20.
105 Ibid.
106 Ibid.
(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) fundamental exchange rate misalignment;

(vi) large and prolonged current account deficits or surpluses; and

(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows.  

Despite a great deal of discussion in the US about labelling China as a "currency manipulator," which could open the door to IMF and/or WTO sanctions, the US has not made any formal moves to this effect. In fact, while President Barack Obama has repeatedly made the claim that the renminbi is undervalued, he has steadfastly refused to take steps toward the branding of China as a currency manipulator, much to the chagrin of many Republican lawmakers. Ignoring for the moment the many political, economic, and policy reasons for not labelling China as a currency manipulator, it is important to recognize that—from a legal perspective—any attempts to do so would be very likely to fail.

Firstly, noteworthy deficiencies and/or omissions in the IMF Agreement include definitions of “manipulation” and of the concept of an “unfair competitive advantage.” This is problematic for any challenge under this approach. The Annex to the Integrated

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107 Ibid at 21.
111 Please see discussion at pages 61-74, below.
112 Trebilcock, Howse & Eliason, supra note 11 at 234.
Surveillance Decision, building on the 2007 Decision, provides “guidance”\textsuperscript{113} with respect to the meaning of Article IV, Section 1 (iii), stating that a country would only be acting inconsistently with this provision if the IMF reached a determination that “(a) the member was manipulating its exchange rate or the international monetary system and (b) such manipulation was being carried out for one of the two purposes specifically identified in Article IV, Section 1(iii).”\textsuperscript{114} Further guidance is provided in the Annex, which states, “’Manipulation’ of the exchange rate is only carried out through policies that are targeted at—and actually affect—the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.”\textsuperscript{115}

Additionally, the Annex states:

A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.\textsuperscript{116}

However, the Annex also states that in any investigation, the IMF will give the country being investigated “the benefit of any reasonable doubt”\textsuperscript{117} as to intention. Prof. Robert Staiger of the University of Wisconsin and Prof. Alan Sykes of the New York University’s School of Law assert that the existence of this “reasonable doubt” standard means that “the issue is not whether China’s stated rationale for policy is sound as a policy matter,

\begin{footnotes}
\footnote{\textsuperscript{113} IMF, \textit{Integrated Surveillance Decision, supra note 101 at 25.}}
\footnote{\textsuperscript{114} Ibid.}
\footnote{\textsuperscript{115} Ibid.}
\footnote{\textsuperscript{116} Ibid.}
\footnote{\textsuperscript{117} Ibid.}
\end{footnotes}
only whether it is sincere.”\textsuperscript{118} Given the interpretive guidance provided by the Annex, it would be extremely difficult to prove ill intent on behalf of a member country; obtaining any sort of remedy would likely be quite difficult. Moreover, the international community must “supply a relevant conception of fairness,”\textsuperscript{119} meaning that some sort of \textit{ex-post} consensus must be reached in order to give this provision any significant meaning. What is fair in a world in which the various countries around the globe use a variety of floating exchange rates and pegged approaches? As Trebilcock, Howse, and Eliason state, “[I]n a world of floating exchange rates, where there is no objective standard such as gold reserves, the concept of a ‘correct’ exchange rate is an elusive one.”\textsuperscript{120}

Secondly, despite the recent Integrated Surveillance Decision, the IMF has very weak surveillance and enforcement mechanisms in place.\textsuperscript{121} Bishop notes that although “the decision does not broaden the definitions of currency manipulation or lower the standard of proof, it does hint that the IMF will intensify surveillance and is more willing to police persistent global imbalances.”\textsuperscript{122} He notes that new language promoting the use of multilateral surveillance—in place of or in addition to bilateral surveillance—in order to evaluate global effects of a particular country’s actions has the potential to “fill the enforcement gap.”\textsuperscript{123} However, this theory is hardly concrete, and if the past is any indication, the IMF is likely to continue with its pattern of weak surveillance and enforcement.\textsuperscript{124}

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\begin{itemize}
  \item \textsuperscript{118} Staiger & Sykes, supra note 17 at 592.
  \item \textsuperscript{119} Trebilcock, Howse & Eliason, supra note 11 at 234.
  \item \textsuperscript{120} Ibid.
  \item \textsuperscript{122} Bishop, supra note 53 at 27.
  \item \textsuperscript{123} Ibid.
  \item \textsuperscript{124} Irwin, supra note 121.
\end{itemize}
Thirdly, although the IMF has been quite ambivalent about many aspects of currency surveillance, the organization has made it clear that it is reluctant to interfere by branding countries as currency manipulators. Wording throughout the Integrated Surveillance Decision is deferential in nature, giving the purportedly offending country the benefit of the doubt as to intention. Even if negative effects can be shown, these effects are not conclusive proof of any wrongdoing; at best, they “might indicate the need for discussion with a member.”\textsuperscript{125} To draw an analogy to criminal law, both \textit{actus reus} and \textit{mens rea} are extremely difficult to pin down in any sort of challenge to a country’s actions under this approach.

Finally, there is no precedent for taking any action under Article XV of the GATT; any WTO cases dealing with Article XV have dealt with subsections other than Article XV:4, meaning that no interpretive light has been shed on this approach.\textsuperscript{126} While the cases of \textit{Argentina — Textiles and Footwear}\textsuperscript{127} and \textit{India — Quantitative Restrictions}\textsuperscript{128} make it clear that WTO Panels must consult with the IMF on issues relating to monetary reserves, balances of payments, or foreign exchange arrangements, it is unclear how these consultations should take place or what should stem from these consultations. While the lack of relevant precedent in this area is not fatal to an attempt at pursuing an action under Article XV of the GATT or the relevant IMF provisions, it certainly makes it more difficult for an action to succeed.\textsuperscript{129} Moreover, although the IMF has the ability to

\begin{thebibliography}{99}
\bibitem{125} IMF, \textit{Integrated Surveillance Decision, supra} note 101 at 21.
\bibitem{126} \textit{GATT 1947, supra} note 80 at Article XV:4.
\end{thebibliography}
engage a state in special consultations when concerns arise over exchange rate policy, these consultations have occurred just twice in the past four decades—Sweden in 1982 and South Korea in 1987. Clearly, the IMF is reluctant to interfere with state exchange rate policy.\textsuperscript{131}

**B. Countervailing Duties**

Article VI:3 of the GATT states that member countries may impose countervailing duties on imports into their domestic market equal to "the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product."\textsuperscript{132} The intent of this Article is to allow for an offsetting remedy to counteract the trade-distorting effects of any production or export remedy from the originating country.\textsuperscript{133} In order for a countervailing duty to be instituted, there must first be a finding that the "effect of subsidization is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry producing like products."\textsuperscript{134}

During the Uruguay Round, WTO members adopted the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"),\textsuperscript{135} which sets out a detailed


\textsuperscript{131} Jung, *supra* note 129 at 185-186.

\textsuperscript{132} *GATT 1947, supra* note 80 at Article XI.

\textsuperscript{133} Trebilcock, Howse & Eliason, *supra* note 11 at 33-35 and 365.


\textsuperscript{135} *Agreement on Subsidies and Countervailing Measures*, 15 April 1994, 1867 UNTS 14 (entered into force 1 January 1995) online: WTO <http://www.wto.org/english/tratop_e/scm_e/subs_e.htm> [*SCM Agreement*].
framework for dealing with subsidy concerns.\textsuperscript{136} Trebilcock describes the SCM Agreement as taking a “red light, yellow light, and green light approach to subsidies.”\textsuperscript{137} The red light refers to the two classes of subsidies that are explicitly prohibited— without proof of any associated trade effects—by Article 3 of the SCM Agreement: subsidies that are contingent upon export performance and those that are contingent upon the use of domestic goods over imported goods.\textsuperscript{138} The green light refers to a limited group of subsidies—including certain subsidies that encourage research and development as well as those that promote compliance with certain environmental regulations\textsuperscript{139}—that have been deemed non-actionable by Article 8 of the SCM Agreement, though these have now expired.\textsuperscript{140} The yellow light refers to subsidies that are deemed to be actionable under Part III of the SCM Agreement;\textsuperscript{141} in-depth evaluation of subsidies in this category is required prior to the taking of any legal actions or remedies.

There are a number of components to a legal analysis under the SCM Agreement. Article 1.1 of the SCM Agreement states that a subsidy shall be deemed to exist if:

\begin{itemize}
\item[(a)(1)(i)] a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
\item[(a)(1)(ii)] government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
\item[(a)(1)(iii)] a government provides goods or services other than general infrastructure, or purchases goods;
\item[(a)(1)(iv)] a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one
\end{itemize}

\textsuperscript{136} Trebilcock, Howse & Eliason, \textit{supra} note 11 at 367-387.
\textsuperscript{137} Trebilcock, \textit{Understanding Trade Law, supra} note 134 at 79.
\textsuperscript{138} Ibid.
\textsuperscript{139} Ibid.
\textsuperscript{140} Ibid.
\textsuperscript{141} Ibid.
or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;”

or

(a)(2) [if] there is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred.142

According to Article 1.2, in order for a subsidy to be subject to the provisions of the SCM Agreement, it must be “specific.”143 Article 2 provides clarification with regard to the specificity issue:

2.1 In order to determine whether a subsidy...is specific to an enterprise or industry or group of enterprises or industries...the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of

142 SCM Agreement, supra note 135.
143 Ibid. For a discussion about specificity, please see pages 27-32, below.
subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.

2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence.144

The Appellate Body addressed Article 2 of the SCM Agreement for the first time in US — Anti-Dumping and Countervailing Duties (China).145 In this case, the Appellate Body provided the following guidance with respect to the proper interpretation of Article 2 in general:

The chapeau of Article 2.1...frames the central inquiry as a determination as to whether a subsidy is specific to “certain enterprises” within the jurisdiction of the granting authority and provides that, in an examination of whether this is so, the “principles” set out in subparagraphs (a) through (c) “shall apply”. We consider that the use of the term “principles”—instead of, for instance, “rules”—suggests that subparagraphs (a) through (c) are to be considered within an analytical framework that recognizes and accords appropriate weight to each principle. Consequently, the application of one of the subparagraphs of Article 2.1 may not by itself be determinative in arriving at a conclusion that a particular subsidy is or is not specific.

144 SCM Agreement, supra note 135.
Article 2.1(a) establishes that a subsidy is specific if the granting authority, or the legislation..., explicitly limits access to that subsidy to eligible enterprises or industries. Article 2.1(b) in turn sets out that specificity “shall not exist” if the granting authority, or the legislation..., establishes objective criteria or conditions governing the eligibility for, and the amount of, the subsidy, provided that eligibility is automatic, that such criteria or conditions are strictly adhered to, and that they are clearly spelled out in an official document so as to be capable of verification...

Article 2.1(a)...focuses not on whether a subsidy has been granted to certain enterprises, but on whether access to that subsidy has been explicitly limited. This suggests that the focus of the inquiry is on whether certain enterprises are eligible for the subsidy, not on whether they in fact receive it...

[T]he introductory sentence of Article 2.1(c) establishes that “notwithstanding any appearance of non-specificity” resulting from the application of Article 2.1(a) and (b), a subsidy may nevertheless be found to be “in fact” specific. The reference in Article 2.1(c) to “any appearance of non-specificity” resulting from the application of Article 2.1(a) and (b) supports the view that the conduct or instruments of a granting authority may not clearly satisfy the eligibility requirements of Article 2.1(a) or (b), but may nevertheless give rise to specificity in fact... Since an “appearance of non-specificity” under Article 2.1(a) and (b) may still result in specificity in fact under Article 2.1(c) of the SCM Agreement, this reinforces our view that the principles in Article 2.1 are to be interpreted together.146

By virtue of Article 2.3, any red light subsidy is deemed to be specific; this presumption is not rebuttable.147 Actionable subsidies—the yellow light class—must, on the other hand, satisfy the other provisions of Article 2. Article 5 of the SCM Agreement lists a series of adverse effects that no member shall inflict upon another country through the use of actionable subsidies.148

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147 Trebilcock, Howse & Eliason, *supra* note 11 at 374-376.
148 Trebilcock, *Understanding Trade Law*, *supra* note 134 at 80;
Article 5 of the SCM Agreement, *supra* note 135 lists the adverse effects as follows: “(a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994; (c) serious prejudice to the interests of another Member.”
In order to evaluate American prospects of succeeding with instituting a countervailing duty in order to counteract the effects of China’s currency undervaluation, it is necessary to examine each approach—red light and yellow light—separately.

**Red Light Approach**

Under the red light approach, the US would claim that China’s policy of currency undervaluation constitutes a prohibited subsidy under Article 3 of the SCM Agreement. The renminbi’s undervaluation would have to fit within the constraints of a subsidy that is contingent upon export performance or that is contingent upon the use of domestic goods over imported goods. An examination of the effects of a policy of currency undervaluation reveals that this approach—under either heading—would be unsuccessful. As many scholars—including Rodrik, Korinek and Serven, and Bishop—contend, it is true that an undervalued currency promotes the domestic production of tradable goods, making exports more attractive to foreign buyers. However, this “export subsidy” effect is not contingent upon export performance or upon the use of domestic goods over imported goods. It is merely a benefit that is attached to a policy of currency undervaluation. Existing simultaneously with this benefit is a negative consequence—effects equivalent to the imposition of a consumption tax on all tradable goods, regardless of country of origin. A low-value currency makes all tradable goods—that is, goods that can easily be shipped around the world and consumed anywhere, according to the laws of supply and demand—more expensive for and

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149 Trebilcock, Howse & Eliason, *supra* note 11 at 376.
150 Korinek & Serven, *supra* note 76.
therefore less attractive to Chinese consumers.\textsuperscript{152} In sum, there is no subsidy that is tied to exports; any effects from a policy of currency undervaluation would extend to the entire Chinese economy.\textsuperscript{153}

**Yellow Light Approach**

A failure under the red light approach pushes the US toward a yellow light class of subsidies. Under this approach, it is necessary to consider firstly whether there is a government program conferring a subsidy. It is then necessary to examine whether specificity exists, and whether adverse effects to some foreign party can be shown. Although there are good arguments\textsuperscript{154} to be made on both sides with respect to whether currency undervaluation represents a government program which confers a subsidy (resulting in a benefit), this becomes largely irrelevant to an evaluation of this class of subsidy, as the specificity requirement is an insurmountable hurdle.\textsuperscript{155} Currency undervaluation is not targeted; it impacts the whole economy—production (especially where tradable imports are required), exports, and imports. It is true that China is predominantly an export-reliant country,\textsuperscript{156} and that any negative impact on importers and consumers is likely outweighed by benefits gained by exporters,\textsuperscript{157} but all exporters benefit—not just those of certain industries. Indeed, as Banjamin Blase Caryl, an American international trade lawyer, notes in his article (which otherwise argues for a finding of the renminbi regime as a countervailable subsidy), the US Department of Commerce “declined to initiate an investigation into the allegation that the Chinese

\begin{itemize}
\item \textsuperscript{152} Ibid.
\item \textsuperscript{153} Trebilcock, *Understanding Trade Law*, supra note 134 at 84-85.
\item \textsuperscript{155} Trebilcock, *Understanding Trade Law*, supra note 134 at 84-85.
\item \textsuperscript{156} Robert C Feenstra & Shang-Jin Wei, eds, *China’s Growing Role in World Trade* (Chicago: University of Chicago Press, 2010) at 1-4.
\item \textsuperscript{157} Ibid.
\end{itemize}
currency regime was a countervailable subsidy”\textsuperscript{158} because it “determined that the petitioners failed to sufficiently allege that ‘the receipt of the excess RMB is contingent on export or export performance,'”\textsuperscript{159} given that this receipt is in fact “independent of the type of transaction or commercial activity for which the dollars are converted or of the particular company or individuals converting the dollars.”\textsuperscript{160} Caryl argues, “[U]nder China’s currency regime, for goods produced in China, exportation is a necessary condition for receiving the subsidy.”\textsuperscript{161} This is true, but it is insufficient to support a claim that the undervalued renminbi constitutes a countervailable subsidy; it ignores the overwhelming fact that, while the undervalued currency may aid exporters, it impacts the entire Chinese economy—without discrimination. Without specificity—the major stumbling block for this approach—it is unimportant whether causation with respect to any purported adverse effects can be established. While WTO Panels have occasionally employed a rather generous interpretation of specificity\textsuperscript{162} with respect to “certain enterprises,” “industries,” or “group of industries,” the Panel in \textit{US — Upland Cotton} stated:

We nevertheless believe that an industry, or group of ‘industries’, may be generally referred to by the type of products they produce. To us, the concept of an ‘industry’ relates to producers of certain products. The breadth of this concept of ‘industry’ may depend on several factors in a given case. At some point that is not made precise in the text of the agreement, and which may modulate according to the particular circumstances of a given case, a subsidy would cease to be specific because it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products. The plain words of Article 2.1 indicate that specificity is a general concept, and the breadth or narrowness of specificity is not susceptible to rigid

\textsuperscript{158} Caryl, supra note 154 at 208.
\textsuperscript{159} Ibid.
\textsuperscript{160} Ibid.
\textsuperscript{161} Ibid at 209 [emphasis in original].
\textsuperscript{162} Trebilcock, Howse & Eliason, supra note 11 at 374–384.
quantitative definition. Whether a subsidy is specific can only be assessed on a case-by-case basis.

We see merit in the shared view of the parties that the concept of “specificity” in Article 2 of the SCM Agreement serves to acknowledge that some subsidies are broadly available and widely used throughout an economy and are therefore not subject to the Agreement’s subsidy disciplines. The footnote to Article 2.1 defines the nature of ‘objective criteria or conditions’ which, if used to determine eligibility, would preclude an affirmative conclusion of specificity. Such criteria are ‘neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.’”  

This view was endorsed by the Appellate Body in US — Anti-Dumping and Countervailing Duties (China). It should be noted that in September 2010, the US House of Representatives passed—by a vote of 348 to 79—the Currency Reform for Fair Trade Act (HR 2378), which would have made it easier for the US Department of Commerce “to determine that an undervalued currency qualifies as an export subsidy” and would have “[defined] the benefit as the difference between the amount of currency the exporter receives and the amount of currency the exporter would have received if the currency were not undervalued, specifying the calculation and data to be used.” However, this bill did not become law because it failed to pass in the US Senate. In March 2013, the bill was reintroduced in the US House of Representatives, though it is widely expected

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164 US—Anti-Dumping, supra note 145.  
166 Ibid.  

to fail once again.\textsuperscript{168} Even if passed, the bill’s impact would be quite limited; China would be likely to successfully bring a challenge against the US to the WTO.\textsuperscript{169}

\textbf{C. Antidumping Provisions}

Antidumping laws are very widely invoked in trade disputes.\textsuperscript{170} Article VI:1 of the GATT states that dumping, the process “by which products of one country are introduced into the commerce of another country at less than the normal value of the products,”\textsuperscript{171} is prohibited “if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry.”\textsuperscript{172} Article VI:1 goes on to state that a finding of dumping can take place if the price of the exported product “is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country”\textsuperscript{173} or, where no domestic price is available in the exporting country, if the price is less than either “the highest comparable price for the like product for export to any third country in the ordinary course of trade”\textsuperscript{174} or “the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.”\textsuperscript{175} GATT Article VI:2 allows for the imposition of an antidumping duty equal to the margin of dumping on the products implicated in the dumping investigation.\textsuperscript{176}

\textsuperscript{168} "HR 1276: Currency Reform for Fair Trade Act", govtrack.us online: govtrack.us <http://www.govtrack.us/congress/bills/113/hr1276>.

\textsuperscript{169} "Congressional Action", supra note 165.

\textsuperscript{170} Trebilcock, Howse & Eliason, supra note 11 at 344-346.

\textsuperscript{171} \textit{GATT 1947, supra} note 80 at Article VI:1.

\textsuperscript{172} \textit{Ibid}.

\textsuperscript{173} \textit{Ibid}.

\textsuperscript{174} \textit{Ibid}.

\textsuperscript{175} \textit{Ibid}.

\textsuperscript{176} \textit{Ibid} at Article VI:2;

See also \textit{Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, 15 April 1994, 1868 UNTS 279} (entered into force 1 January 1995) \textit{[Anti-Dumping Agreement]}. 

In the US, the International Trade Administration of the Department of Commerce is responsible for determining whether dumping is taking place and, if so, determining the margin of dumping in a particular case.177 There are two main issues relating to any such analysis by the International Trade Administration with respect to an investigation into alleged dumping deriving from renminbi undervaluation. Firstly, as previously mentioned,178 the effects of an undervalued currency are simultaneously comparable to the existence of both export subsidies (for the production of tradable goods) and consumption taxes (for all tradable goods, imported or domestically produced).179 These effects would not support a finding of dumping; the domestic price for the same or like products is unlikely to be much different from prices in importing or third countries. After all, one of the intentions of a policy of currency undervaluation is to deter domestic consumption, which encourages savings and investments into the economy as a whole, driving further industrialization and technological progress.180 As the Panel held in Egypt — Steel Rebar, in order to satisfy the requirements of Article 3.2 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Antidumping Agreement"),181 a price-underselling analysis must focus on a “delivered-to-the customer basis, as...it is only at that level that any such underselling can influence customers’ purchasing decisions.”182

177 Trebilcock, Howse & Eliason, supra note 11 at 346-348.
178 Please see discussion at pages 7-13, above.
179 Bishop, supra note 53 at 16 & 18.
180 Liew & Wu, supra note 6 at 21-24.
181 Anti-Dumping Agreement, supra note 176.
Even if the International Trade Administration insisted on using constructed values\textsuperscript{183} as a comparison to imported prices,\textsuperscript{184} the input costs—labour, material, general, and administrative expenses\textsuperscript{185}—are likely to be quite low, due to the low value of the renminbi, though costs may be imputed using a surrogate third country because China is a non-market economy.\textsuperscript{186} Secondly, even if a dumping determination can be made (and it is doubtful it can), an injury determination must then be made and causation must be established.\textsuperscript{187} According to Article 3.4 of the Antidumping Agreement, there are a number of possible indicators of material injury, such as actual or potential decline in sales, profits, output, market share, productivity, and return on investments.\textsuperscript{188} However, under Article 3.5 of this Antidumping Agreement, a causal relationship between the act of dumping and the purported injuries must be established.\textsuperscript{189} In \textit{US — Hot-Rolled Steel},\textsuperscript{190} the Appellate Body acknowledged the difficulty associated with distinguishing the injurious effects of various causal factors,\textsuperscript{191} but stated:

\begin{quote}
[A]lthough this process may not be easy, this is precisely what is envisaged by the non-attribution language. If the injurious effects of the dumped imports and the other known factors remain lumped together and indistinguishable, there is simply no means of knowing whether injury ascribed to dumped imports was, in reality, caused by other factors. Article 3.5, therefore, requires investigating authorities to undertake the process of assessing
\end{quote}

\textsuperscript{185} Trebilcock, \textit{Understanding Trade Law}, \textit{supra} note 134 at 63.
\textsuperscript{186} Liew & Wu, \textit{supra} note 6 at 21-24.
\textsuperscript{187} Trebilcock, Howse & Eliason, \textit{supra} note 11 at 336-341 and 346-347.
\textsuperscript{188} \textit{Anti-Dumping Agreement}, \textit{supra} note 176 at Article 3.4.
\textsuperscript{189} \textit{Ibid} at Article 3.5.
\textsuperscript{191} \textit{Ibid}. 
appropriately, and separating and distinguishing, the injurious effects of dumped imports from those of other known causal factors.¹⁹²

As Trebilcock notes, the US has been notorious for using investigative techniques that equate correlation with causation, often attempting to show that acts of dumping by foreign countries have coincided with downturns in the US economy.¹⁹³ Trebilcock advocates the use of a unified or integrated approach, which creates a counterfactual where the price of imported goods is hypothetically raised to such a level that eliminates any purported margin of dumping and compares the likely market effects from this hypothetical scenario with the actual market data;¹⁹⁴ this approach is less susceptible to a WTO challenge than typical US investigative and calculative techniques.¹⁹⁵

It would be extremely difficult to prove causation with respect to negative effects flowing from any alleged Chinese dumping (resulting from the renminbi’s undervaluation), primarily because this would require isolating injuries stemming directly from China’s currency policy, as opposed to considering injuries flowing from all other factors impacting the relevant industries. This, of course, assumes that dumping could be shown in the first place, which would itself be unlikely.

D. Safeguards

The foundation for the WTO’s safeguards regime is set out at Article XIX of the GATT, which states:

¹⁹² Ibid at para 228.
¹⁹³ Trebilcock, Understanding Trade Law, supra note 134 at 68; Trebilcock, Howse & Eliason, supra note 11 at 344-347.
¹⁹⁴ Trebilcock, Understanding Trade Law, supra note 134 at 68.
¹⁹⁵ Ibid.
If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.196

This Article requires a country to give notice to all other members of the WTO of its intention to institute safeguards prior to acting.197 Moreover, any member country “having a substantial interest as exporters of the product concerned”198 shall be afforded “an opportunity to consult with it in respect of the proposed action.”199 Opportunities to consult may prompt negotiations of compensatory trade concessions.200 Where agreement cannot be reached regarding compensation, however, affected countries “may suspend substantially equivalent concessions or other obligations under the GATT.”201

The ambiguous nature of many terms and concepts used in Article XIX of the GATT led to several attempts to negotiate a clear set of rules to monitor the use of safeguards. The first such attempt took place in the late 1970s during the Tokyo Round.202 Trebilcock describes the negotiations as follows:

[T]hese negotiations floundered over disagreements as to whether safeguards should be permitted on a selective, as opposed to a non-discriminatory basis; whether compensation, in the form of offsetting trade concessions, or, in the absence of agreement on compensation, retaliation should be permitted

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196 GATT 1947, supra note 80.
197 Ibid at Article XIX at 2.
198 Ibid.
199 Ibid.
200 Trebilcock, Understanding Trade Law, supra note 134 at 90.
201 Ibid.
202 Trebilcock, Howse & Eliason, supra note 11 at 412-414.
where legitimate safeguard action has been taken; how ‘serious injury’ should be defined; whether there should be political discretion in the imposition of safeguard measures (as opposed to administrative determinations as under antidumping and countervailing duty laws); and the role for multilateral oversight of the invocation of safeguard measures.  

A code addressing the use of safeguards was finally negotiated and agreed to during the Uruguay Round.

This code, the Agreement on Safeguards, has clarified many terms and concepts stemming from Article XIX of the GATT. For example, Article 4 of the Agreement defines “serious injury” as “a significant overall impairment in the position of a domestic industry.” Meanwhile, the Agreement also clarifies that “threat of serious injury” refers to a “serious injury that is clearly imminent,” and any determination regarding the existence of a threat of serious injury “shall be based on facts and not merely on allegation, conjecture or remote possibility.”

Article 4.2(a) of the Agreement provides that during an investigation into the effect of increased imports on a country’s domestic economy, “all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry” must be considered and evaluated. These factors include “the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.” In order for an affirmative determination to be made under Article 4.2(a), a “causal link

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203 Trebilcock, Understanding Trade Law, supra note 134 at 90.
204 Trebilcock, Howse & Eliason, supra note 11 at 414.
206 Ibid.
207 Ibid.
208 Ibid.
209 Ibid.
between increased imports of the product concerned and serious injury or threat thereof” must be shown according to Article 4.2(b). This provision goes on to state that “[w]hen factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports.”

Article 2.1 of the Agreement provides that a country may adopt safeguard measures only where the member has determined that the product in question “is being imported...in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.”

Article 2.2 specifically states that safeguard measures “shall be applied to a product being imported irrespective of its source.” Article 5.2 considers where a quota is employed as a safeguard measure and specifies that the country adopting the measure “shall allocate the quota [shares] to members having a substantial interest in supplying the product...based upon the proportions of imports supplied by such members during a...representative period.” A country may deviate from this non-discrimination requirement if it can demonstrate that:

1) imports from certain members have increased disproportionately in relation to the total increase of imports of the product concerned in the representative period;
2) the reasons for the departure from a non-discriminatory allocation of quotas are justified; and
3) the conditions of such departure are equitable to all suppliers of the product concerned.

Safeguards and safeguard measures are intended to be temporary in nature.

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210 Ibid.
211 Ibid.
212 Ibid at Article 2.1.
213 Ibid at Article 2.2.
214 Ibid at Article 5.2.
215 Trebilcock, Understanding Trade Law, supra note 134 at 91.
Article 7 states that safeguards cannot be implemented for more than four years except where the authorities of the importing country establish that the continuation of the measures is “necessary to prevent or remedy serious injury and that there is evidence that the industry is adjusting.”\(^{216}\) In that case, the safeguard measure cannot be instituted for longer than a cumulative total of eight years and cannot be reinstated for the period that the prior measure was in effect.\(^{217}\) Furthermore, countries are required to ensure that safeguard measures are “progressively [liberalized]...at regular intervals during the period of application”\(^{218}\) by virtue of Article 7.4.

Although this paper focuses on the general GATT safeguards regime—comprised of Article XIX of the GATT and the *Agreement on Safeguards*—it is important to recognize that specific safeguard regimes also exist within other agreements, such as the Uruguay *Agreement on Agriculture* (at Article 5), the *General Agreement on Trade in Services* [“GATS”] (at Article X), and in the *Agreement on Apparel, Textiles, and Clothing* (at Article 6).\(^{219}\)

**Relevant Decisions in Cases Involving Safeguards**

Safeguard measures have been used infrequently in comparison to other trade remedies.\(^{220}\) Trebilcock, Howse, and Eliason note that there were 208 safeguard investigation initiations reported to the WTO Committee on Safeguards between January 1995 and October 2009, with just under 20 percent of cases being initiated by developed countries.\(^{221}\) In contrast, during this same time period, there were

\(^{216}\) *Agreement on Safeguards*, supra note 205 at Article 7.2.

\(^{217}\) Ibid at Article 7.

\(^{218}\) Ibid at Article 7.4.


\(^{220}\) Trebilcock, Howse & Eliason, *supra* note 11 at 411.

\(^{221}\) Ibid.
approximately 3,500 antidumping initiations and roughly 200 countervailing actions.\textsuperscript{222}

WTO Panels and the Appellate Body have made a number of important decisions concerning safeguards. In \textit{Argentina—Footwear}, the Appellate Body addressed the difference in wording between Article XIX of the GATT and Article 2.1 of the \textit{Agreement on Safeguards}. In particular, this case considered that the latter does not seem to include the requirement from the former that an increase in imports be “as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under [the GATT].”\textsuperscript{223} The Appellate Body concludes:

\begin{quote}
We see nothing in the language of either Articles 1 or Article 11.1(a) of the Agreement on Safeguards that suggests an intention by the Uruguay Round negotiators to subsume the requirements of Article XIX of the GATT 1994 within the Agreement on Safeguards and thus to render those requirements no longer applicable. Article 1 states that the purpose of the Agreement on Safeguards is to establish ‘rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT 1947...’ This suggests that Article XIX continues in full force and effect, and, in fact, establishes certain prerequisites for the imposition of safeguard measures. Furthermore, in Article 11.1(a), the ordinary meaning of the language ‘unless such action conforms with the provisions of that Article applied in accordance with this Agreement’...clearly is that any safeguard action must conform with the provisions of Article XIX of the GATT 1994 as well as with the provisions of the Agreement on Safeguards. Neither of these provisions states that any safeguard action taken after the entry into force of the WTO Agreement need only conform with the provisions of the Agreement on Safeguards.\textsuperscript{224}
\end{quote}

As such, a country may only initiate safeguard measures in response to unforeseen developments and the harm—or potential harm—must result from (failed) obligations

\begin{footnotesize}\begin{itemize}
\item \textsuperscript{222} Ibid.
\item \textsuperscript{223} \textit{Argentina – Safeguard Measures on Imports on Footwear} (1999) WTO Docs WT/DS121/R at 8.50 (Panel Report), online: WTO <http://docsonline.wto.org>.
\item \textsuperscript{224} \textit{Argentina – Safeguard Measures on Imports on Footwear} (1999) WTO Docs WT/DS121/AB/R at 83 (Appellate Body Report), online: WTO <http://docsonline.wto.org> ["Argentina – Footwear (1999)"].
\end{itemize}\end{footnotesize}
under the GATT. As Trebilcock states, Appellate Body case law indicates that “the relevant point of time for determining whether developments have been unforeseen is when the last tariff concession was made with respect to the class of product in question.” Unforeseen developments have been considered to be those that are “‘unexpected’ by trade negotiators at the time when such concessions were negotiated.” This requirement has been given a fairly strict interpretation by both WTO Panels and by the Appellate Body, to the extent that “only increases in imports attributable to unforeseen developments can be considered in determining whether increasing imports are causing serious injury.”

The Appellate Body also clarified in Argentina—Footwear that to determine whether imports are increasing “requires consideration of trends over a representative period (often five years), not simply the end points of this period.” The increase in imports “must have been recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause ‘serious injury’.”

The Appellate Body clarified in US—Lamb that “serious injury” in Article 4 of the Agreement on Safeguards denotes a higher standard than “material injury.” Material injury is the related requirement for cases involving antidumping measures or countervailing duties.

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225 Trebilcock, Howse & Eliason, supra note 11 at 411.
226 Trebilcock, Understanding Trade Law, supra note 12 at 94.
227 Ibid.
228 Ibid.
229 Ibid.
230 Ibid.
231 Argentina—Footwear (1999), supra note 224 at 131.
233 Trebilcock, Howse & Eliason, supra note 11 at 417-418.
The Appellate Body has maintained a strict application of the non-attribution requirement set out in Article 4.2(b) of the Agreement on Safeguards in determining causation, though increased imports need not constitute the only source of serious injury. This indicates that determining causation is a two-step process: first, the injury to the domestic industry by increased imports must be distinguishable from injury caused by other factors, and, second, the precise degree of injury as a result of increased imports must be attributed to this cause, so as to avoid attributing the entirety of the injury to increases in imports. Although this seems to be rather perplexing, it means that the threshold issue of meeting the requirement of the existence of “serious injury” (or the threat thereof) can be addressed by looking at the “total injury”; that is, this “does not require that the increased imports be capable, on their own, of causing serious injury.” Nevertheless, determining the degree to which safeguards have caused injury requires competent authorities to demonstrate causation and carefully exclude injuries attributable to other sources.

Regarding the non-discrimination principle set forth in Article 2.2 of the Agreement on Safeguards, the Appellate Body has held that “imports included under Articles 2.1, 2.2 and 4.2...should correspond with one another (this is commonly referred to as ‘parallelism’).” For example, the Appellate Body found that it was improper for the US to have “included imports from all sources in its investigation of increased imports and their consequent effects, while excluding imports from Canada in

233 Trebilcock, Understanding Trade Law, supra note 134 at 95.
235 Trebilcock, Howse & Eliason, supra note 11 at 416.
236 Ibid.
237 Ibid.
the ultimate application of the safeguard,” as the US “did not establish explicitly that imports from those sources to which the safeguard was applied, excluding Canada, satisfied Articles 2.1 and 4.2,” in *US—Wheat Gluten.*

Finally, regarding duration, *US—Line Pipe* indicates that safeguard measures may only be implemented for as long as necessary to address serious injuries attributable to increased imports—and not injuries caused by any other factors.

To summarize, five key factors must be established in any action involving the adoption of safeguard measures: first, there must be unforeseen developments; second, there must be prior obligations or commitments to liberalize trade; third, the first two elements must be shown to lead to increased imports; fourth, there must be serious injury or threat of serious injury; and, fifth, it must be shown that the first three elements cause a significant portion of the injury, and that safeguards could assist in counteracting this effect.

**Issues with the Current WTO Safeguards Regime**

Safeguard measures have featured prominently in trade disputes, and several cases have resulted in WTO Panel and Appellate Body decisions. These measures have not fared well in trade law challenges historically. Sykes has provided a particularly severe criticism of the safeguards regime, advancing the position that the

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239 Ibid.
240 Ibid.
243 Trebilcock, Howse & Eliason, *supra* note 11 at 419.
244 Michael Trebilcock, International Trade Regulation Lecture Notes – Safeguards (Faculty of Law, University of Toronto, 16 October 2012).
current regime, as interpreted by WTO Panels and the Appellate Body, has become practically impossible to comply with. In response to this critique, Prof. Yong-Shik Lee of the University of Manchester’s School of Law has argued that it is possible states have been using safeguard measures as “a convenient political means to appease protectionist demands without economic and legal justifications.”

Sykes argues that without a clear position from the WTO regarding the role that safeguard measures are intended to play, this will remain a controversial topic. He posits that the requirement for establishing that serious injury results from “unforeseen developments” is especially troublesome, as this is highly restrictive and “impossible to apply on a predictable and principled basis.” Furthermore, it is very difficult to make out causation from increases in imports because many causes are interrelated.

Trebilcock, Howse, and Eliason explain:

>[A]ny attempts to separate out various potential causes of serious injury or threat thereof are doomed because of the endogeneity of increased imports to other causal factors. For instance, suppose that domestic demand for a good rises due to rising consumer incomes. A natural result of this increase in demand would be for imports to increase. Similarly, one can imagine input costs rising domestically, causing the costs of domestic production to increase, and thereby advantaging foreign producers. Increased quantities of imports will be a natural result. While the [Appellate Body] looks for increased imports to explain why injury may be occurring, increases in imports are often the result, not the cause, of unfavourable shifts in market conditions. The ‘non-attribution’ analysis is therefore deeply flawed—the [Appellate Body] might try to distinguish the injury caused by increased imports from the injury caused from higher labour costs or energy costs, or changing demand patterns, for example, but such an exercise ignores the causal relationship that

247 Ibid at 252-253.
249 Sykes, supra note 246 at 252-253.
250 Trebilcock, Howse & Eliason, supra note 11 at 417.
251 Sykes, supra note 246 at 252-253.
exists between potential factors.\textsuperscript{252}

Sykes also adds that the WTO Panels and the Appellate Body have not given sufficient interpretive guidance to date and instead have left many legal questions unanswered. It has been established that there are many impermissible approaches to safeguards, but little has been determined about what would enable safeguard measures “to pass muster.”\textsuperscript{253} This incentivizes countries to adopt “extra-legal arrangements, such as Voluntary Export Restraint Agreements or Orderly Marketing Agreements,”\textsuperscript{254} which are often more trade-distorting than formal safeguard measures.\textsuperscript{255}

Robert A. Rastorp, a Canadian lawyer and legal scholar, agrees with Sykes regarding the “unintelligibility”\textsuperscript{256} of the requirement for unforeseen developments, saying that this becomes a factually confusing factor and “is in itself [an] irrelevant [consideration] from the standpoint of the political incentives affecting domestic decision-makers.”\textsuperscript{257} Furthermore, Rastorp notes that “[d]omestic...pressure groups do not care whether the developments that are damaging their industry were foreseen or unforeseen—they only care that their industry, apparently, is being damaged by import competition.”\textsuperscript{258} This factor also has no relation to the possible rationales—as explored by legal scholars—for the existence of a safeguards regime.\textsuperscript{259}

Rastorp is also critical of the requirement that an increase in imports must be

\begin{footnotesize}
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\item[\textsuperscript{252}] Trebilcock, Howse & Eliason, \textit{supra} note 11 at 416-417.
\item[\textsuperscript{253}] Sykes, \textit{supra} note 246 at 252.
\item[\textsuperscript{254}] Trebilcock, \textit{Understanding Trade Law, supra} note 134 at 93; Voluntary Export Restraint Agreements unilaterally place restrictions on the quantity of a particular good that may be exported at any given time while Orderly Marketing Agreements are bilateral agreements in which an exporting country voluntarily places limits of its exports without the importing country resorting to tarrifs or otherwise.
\item[\textsuperscript{255}] \textit{Ibid}.
\item[\textsuperscript{256}] Robert Alexander Rastorp, \textit{Theoretical Rationales for the WTO Safeguard Regime} (LLM Thesis, University of Toronto Faculty of Law, 2004) [unpublished] at 138.
\item[\textsuperscript{257}] \textit{Ibid}.
\item[\textsuperscript{258}] \textit{Ibid}.
\item[\textsuperscript{259}] \textit{Ibid} at 140. Please see discussion at pages 47-53, below.
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proven prior to the adoption of safeguard measures; he sees this as a strictly
quantitative approach that is blind to qualitative concerns, including those originating
in technological advances and innovations.260

Moreover, Rastorp criticizes the arbitrary duration limit imposed by Article 7 of
the Agreement on Safeguards because he argues that the rules regarding the use of
safeguards should be focused “on allowing the period of safeguards relief to correspond
with the period needed for a nascent or emergent high-tech industry to become
internationally competitive, which obviously may vary on the facts.”261

A number of scholars have also noted that little guidance is provided as to the
meaning of “like or competitive product,” so that the scope of the domestic industry—
relevant to any discussion about possible safeguard measures—is difficult to
determine.262

Partially building off of Sykes’ public-choice-theory-inspired critiques,263
Rodrik’s main criticism of the current safeguards regime is that it is too restrictive to be
effective. In order to serve its intended purpose—to provide for a certain degree of
flexibility in order to ensure the survival of the global trade system—it is necessary to
expand the use of safeguards, allowing them to be employed in a wide variety of
situations.264 He also says that the requirement for non-discrimination prevents
safeguards from being properly targeted in specific scenarios, reducing their potential
effectiveness.265

260 Ibid at 142.
261 Ibid at 174.
262 Ibid at 164.
263 For a description of public choice theory, please see page 51, below.
264 Rodrik, supra note 14 at 257-258.
265 Ibid at 256.
The strict requirements of the current WTO safeguards regime mean that it would be very difficult for the US to effectively employ safeguard remedies against China with respect to renminbi undervaluation. The first significant challenge with this approach would be attempting to show that effects relating to Chinese currency undervaluation constitute unforeseen developments, considering that this practice is not novel.\(^{266}\) Secondly, attempting to attribute a significant portion of the downturn in segments of the US economy to Chinese currency undervaluation could be problematic, as this is difficult to measure and prove empirically. Thirdly, the current safeguards regime would be extremely inefficient insofar as the US is concerned, as separate safeguards would be required for each product category, and these safeguards could only be in place for four years at a time.

A new, redesigned safeguards regime would likely afford the US the best opportunity to combat the effects stemming from China’s practice of undervaluing the renminbi.

V. How would a new safeguards regime address concerns relating to currency undervaluation?

Rationales for the Existence of the WTO Safeguards Regime

Before a new safeguards regime can be proposed, it is necessary to assess the efficacy of the current regime. Evaluating the effectiveness of the current safeguards regime requires an understanding of why the WTO features an “escape clause”\(^{267}\) such as this. A number of theoretical rationales attempt to explain the existence of a

\(^{266}\) Staiger & Sykes, supra note 17.

safeguards regime.

From an economic viewpoint, scholars, including Prof. John H. Jackson of Georgetown University,\(^\text{268}\) have argued that safeguards “permit domestic industries that have lost their competitiveness vis-à-vis imports a ‘breathing space’ to restructure themselves and become competitive again.”\(^\text{269}\) Even if it proves to be impossible for a country to return to a state of competitiveness throughout the industry, this breathing space would at the very least provide time for a more gradual and less disruptive contraction or decline of firms in that sector. This would ease—or at least spread out—the burden placed on affected employees, investors, and communities.\(^\text{270}\) This conceptualization of the role of safeguards has its roots in the concept of offering (relatively brief) periods of protection from international competition to infant industries in order to foster domestic growth in these sectors.\(^\text{271}\) However, it is important to recognize that, with regard to safeguards, many affected industries being propped up by safeguard measures were once quite strong, but have become less competitive over time.\(^\text{272}\)

However, a strictly economic explanation for the existence of a safeguards regime seems unpersuasive, as imports stemming from trade liberalization typically increase overall societal welfare.\(^\text{273}\) Even where domestic firms in specific sectors are harmed by an increase in imports, it would be more efficient to reallocate—on a domestic level—the gains from trade liberalization, effectively resulting in the domestic


\(^{269}\) Trebilcock, *Understanding Trade Law*, *supra* note 134 at 97.

\(^{270}\) Ibid.

\(^{271}\) Rodrik, *supra* note 14 at 198-200.

\(^{272}\) Trebilcock, *Understanding Trade Law*, *supra* note 134 at 97.

\(^{273}\) Rastorp, *supra* note 256 at 40-42.
“winners” from trade liberalization compensating the domestic “losers.” Instead, safeguard measures—instituted to prevent certain aspects of international trade from occurring—limit the benefits of trade liberalization in lieu of taking the benefits for the country and reallocating some of them; this serves to reduce social welfare.

A different rationale emphasizes the notion of fairness. The “adverse impacts of increasing imports of low-priced products may have distributionally and socially unfair consequences for low-paid, low-skilled, immobile workers, and dependent communities” may tempt scholars to support the existence of a safeguards regime on the basis of distributive-justice considerations. However, Trebilcock explains that several “empirical studies have shown that [safeguards] and related forms of protectionist relief often entail costs for domestic consumers that are several orders of magnitude greater than the value of jobs preserved.” Different policy instruments—such as effective job-retraining programs—would likely address distributive-justice concerns at a much lower cost than protectionist measures—including safeguards—as they are currently contemplated. Moreover, it is not clear why the normative case to intervene to address concerns stemming from the shock of imports is stronger than for intervening to address market shocks due to other sources.

Certainly, other factors serve to incentivize those responsible for making political policy decisions. The implication of this is that a political economy approach is necessary to truly appreciate the influences at play in developing and perpetuating a

\[\text{Ibid at 42.}\]

\[\text{Ibid at 41-42.}\]

\[\text{Trebilcock, Understanding Trade Law, supra note 12 at 98.}\]

\[\text{Ibid.}\]

\[\text{Rastorp, supra note 256 at 46.}\]

\[\text{Trebilcock, Understanding Trade Law, supra note 134 at 98.}\]
safeguards regime.280

Sykes gives three possible political economy explanations for the existence of safeguards.281 The first is founded on the notion of having a “domestic political ‘safety valve’ for protectionist pressures, deflecting them into an administrative process” implemented by competent authorities instead of politicians, thus reducing the political risk of making trade liberalization commitments in the first place. However, this explanation is flawed, as it overlooks the fact that, by allowing states to opt out of their international commitments under certain circumstances, this system “[encourages] the pursuit of protection by import-competition interest groups.”282 Moreover, by depoliticizing the act of pursuing protectionism—that is, by forcing special interest groups to go through administrative rather than merely political channels—this has the effect of making these pursuits more accessible, as costly lobbying efforts are no longer required (at least not to the same degree) in order for organizations to voice their concerns.283

The second political economy rationale identified by Sykes is that safeguard measures “facilitate deviation from trade commitments when the political pressure to do so is intense, and when nations would otherwise ‘cheat’ on commitments anyway to the detriment of the trading system in the long run.” However, this hypothesis, advanced by Kyle Bagwell and Robert W. Staiger,284 fails to account for the fact that safeguards can at present only be used in cases where increased imports can be demonstrated. The present safeguards regime does not function as a general escape

280 Lee, supra note 248 at 12.
281 Sykes, supra note 246 at 59.
282 Ibid.
283 Ibid at 60.
284 Ibid at 60-61.
clause and safeguard measures cannot be implemented in instances where political pressure may also be intense but where no proof of increased imports can be established.286

The third political economy explanation identified by Sykes is that safeguard measures “may be useful because they reduce the risk of trade concessions under conditions of political uncertainty, and thereby facilitate more of them.”287 Kenneth Dam, the former Deputy Secretary of the US Treasury, has supported this position and argues that the existence of safeguards “encourages cautious countries to enter into a greater number of tariff bindings than would otherwise be the case” because “the opportunity to impose safeguard measures ex post leads to more trade concessions ex ante.”288

This stance is rooted in public choice theory, which Rastorp explains as follows:

A public choice perspective on the desirability of a safeguard regime...is concerned strictly with the political incentives that structure the behaviour of domestic political decision makers, both in agreeing to include a safeguard regime in the treaty text during its negotiation, and in subsequently complying with that treaty text. Public choice theory is rooted in the rational actor assumptions of liberal economic theory, and seeks to transfer those assumptions to the political domain, explaining policy outcomes...as the consequence of self-interested behaviour by political decision-makers who are in competition with each other for the votes of the electorate (which reflect the policy preferences of voters). In effect, there is a market for policy outcomes, political decision-makers are the ‘suppliers’ in that market...and voters are the ‘customers’.289

This position—and the field of political economy generally, encompassing many aspects of public choice theory, as described by Rastorp—assists in explaining the presence of

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286 Sykes, supra note 246 at 63.
287 Ibid at 59.
288 Ibid at 64.
289 Rastorp, supra note 256 at 47.
an escape clause that, at least theoretically, allows countries to opt out of particular
trade-liberalization obligations. Because of political pressures, it may be rational for
politicians to advance the adoption of policies that have a negative impact for society on
net. Since politicians rely on votes in order to gain or remain in office, and because
significant fundraising efforts are required in order to run political campaigns,\(^{290}\) it may
make sense for politicians to cater to powerful groups advocating for the adoption of
policies that may benefit them but harm society as a whole.\(^ {291}\) Knowing that a state can
resort to protectionist measures in particular circumstances would encourage more
politicians to enter trade-liberalization agreements initially because, in the end, “[a]s
self-interested actors, political leaders face competing incentives on a domestic
level,”\(^ {292}\) and these incentives impact their “willingness to cooperate with other states
in a liberalized trade regime.”\(^ {293}\)

Rastorp agrees with Sykes in that it is “correct to look at political incentives on
the domestic level of analysis,”\(^ {294}\) although he argues for the adoption of a “‘two-level
game’ perspective”\(^ {295}\) in order to better explain international as well as domestic
incentives.\(^ {296}\) A full examination of possible theoretical rationales for the existence of a
safeguards regime is beyond the scope of this paper; it is sufficient to conclude that the
field of political economy provides the most convincing justifications for the

\(^{292}\) Rastorp, *supra* note 256 at 49.
\(^{293}\) *Ibid*.
\(^{294}\) *Ibid* at 51.
\(^{295}\) *Ibid* at 2. A two-level game perspective views international negotiations between countries as consisting of contemporaneous negotiations involving government actors at both the domestic level (dealing with special interest groups and other domestic political parties, for instance, with the goal being to garner widespread national support for an initiative) and the international level (dealing with other countries’ governments and international bodies, with the goal being to reach an international agreement that will not result in negative political or economic consequences in the domestic sphere).
\(^{296}\) *Ibid*. 
development and perpetuation of the WTO safeguards regime. Safeguards are present because political leaders have determined they must exist, mainly for political reasons; their presence is not explained solely by economic or distributive-justice considerations.

**Overview and Critique of Rodrik’s Proposal**

Rodrik argues for a significantly expanded safeguards regime and encourages WTO members to embrace the political and discretionary nature of the escape-clause concept.\(^\text{297}\) In short, he posits that if the WTO is to have an escape clause due to political economy considerations—and not strictly economic concerns—members should be open and explicit about this instead of attempting to hide their political motivations behind the *façade* of administrative processes.\(^\text{298}\) The mechanism by which safeguards come into being should reflect the *raison d’être* for safeguard measures; institutional design should reflect purpose.\(^\text{299}\)

Rodrik anticipates that more countries—especially developing countries—would sign trade-liberalization agreements if they knew they would be given flexibility regarding growth strategies.\(^\text{300}\) He argues that opt-outs—in the form of safeguards—should be permissible in a much wider set of circumstances than contemplated under the current regime.\(^\text{301}\)

While Rodrik’s proposal lacks many specifics, he is adamant that there should be a democratic-procedure requirement, which “might include transparency,

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\(^{297}\) *Ibid* at 252–255.

\(^{298}\) *Ibid* at 252–258.

\(^{299}\) *Ibid*.

\(^{300}\) *Ibid* at 259.

\(^{301}\) *Ibid* at 252–254.
accountability, inclusiveness, and evidence-based deliberation.” Rodrik would have this democratic-procedure criteria replace the serious injury test that presently exists.

Rodrik also suggests expanding the safeguards regime to cover areas other than strictly quantitative concerns about import numbers. He argues that a new safeguards agreement, written to “expand policy space under a broader set of circumstances,” should be adopted. He acknowledges that countries “may wish to restrict trade or suspend WTO obligations...for reasons other than a competitive threat to their industries.” Rodrik envisions allowing opt-outs where strict adherence to WTO rules would “threaten to undermine domestic labor and environmental standards or when they hamper the pursuit of sound development policies.” He also suggests permitting opt-outs for “[d]istributional concerns, conflicts with domestic norms and social arrangements, prevention of the erosion of domestic regulations” or other “legitimate grounds,” which he foresees being “recast into an expanded Agreement on Developmental and Social Safeguards.” It would also be necessary to amend Article XIX of the GATT, as Appellate Body decisions establish that the wording of the Article must be satisfied.

Essentially, under Rodrik’s proposal, nearly anything could be considered a legitimate reason for wanting to opt out of WTO rules. He argues that “[e]xpanding

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302 Ibid at 254.
303 Ibid at 253-254.
304 Ibid at 254.
305 Ibid at 253.
306 Ibid.
307 Ibid.
308 Ibid.
309 Ibid.
310 Ibid.
policy space to accomplish domestic objectives does not negate an open, multilateral trade regime,”³¹¹ but that in fact “it is a precondition for it.”³¹²

Rather than focus on and restrict analysis to the motivating factor for a country’s desire to escape certain trade rules in a particular situation, Rodrik’s primary concern is with the manner in which a country arrives at a decision to adopt a safeguard measure. The “key procedural requirement”³¹³ would be that a country must “demonstrate that it followed democratic procedures in reaching the determination that a safeguard measure is in the public interest.”³¹⁴ WTO Panels and the Appellate Body would maintain jurisdiction³¹⁵ in reviewing complaints against adopting safeguard measures. However, this jurisdiction would be restricted to “procedural rather than substantive grounds.”³¹⁶ Rodrik clarifies that the focus would be the “degree to which democratic requirements were fulfilled.”³¹⁷ He states:

Were the views of all relevant parties, including consumer and public interest groups, importers and exporters, civil society organizations, sufficiently represented? Was all relevant evidence, scientific and economic, brought to bear on the final determination? Was there broad enough domestic support in favor of the opt-out...in question? The [WTO Panels] may rule against a country because the internal deliberations excluded an interested party or relevant scientific evidence. But they would not be able to rule on the substantive claim—whether in fact the safeguard measure serves the public interest at home by furthering a domestic social purpose or promoting economic development at home.³¹⁸

As such, Rodrik’s concern is not about “the public interest,” defined in conventional local welfare terms, but rather the degree of genuine popular support for a

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³¹¹ Ibid.
³¹² Ibid.
³¹³ Ibid at 254.
³¹⁴ Ibid.
³¹⁵ Ibid.
³¹⁶ Ibid.
³¹⁷ Ibid.
³¹⁸ Ibid.
proposed safeguard measure. This recognizes the political economy factors discussed above; after all, “[a] sustainable trade regime ultimately rests not on external constraints but on domestic political support.”

While I agree with Rodrik that an expanded approach to safeguards—allowing for greater flexibility in the use of opt-outs—is needed from a political economy perspective to ensure the overall health and security of the international trade system, I am concerned with a several aspects of Rodrik’s proposal.

Instead of focusing on the degree to which safeguard deliberations occur in a “democratic” manner, there should be an emphasis on creating a mechanism to disincentivize the abuse of safeguards. Because safeguard measures are inherently political and discretionary, the WTO safeguards regime ought to be sufficiently flexible to allow countries to employ safeguard remedies in situations where they would have previously been left without the ability to take steps to ensure the health of their own economies against threats to development or stability stemming from the actions of other countries. However, countries opting to use such an escape clause should be forced to bear at least a very large portion of the global costs associated with the implementation of their protectionist measures.

Rodrik’s proposal—and, most notably, his preoccupation with the idea of democratic deliberations—is problematic for a number of reasons. Firstly, his system is input-focused, insofar as it is concerned with procedural matters regarding the decision-making process rather than outputs—namely, the decisions themselves. It will likely be very difficult for a WTO Panel to assess the degree to which a process is deemed to be democratic. Furthermore, Rodrik overlooks the many flaws of democracy

\(^{319}\) Ibid.
(at least in its most common forms in North America and Europe) when he makes the claim that “[t]he most reliable guarantee against abuse of opt-outs is informed deliberation at the national level.”\textsuperscript{320} Public choice theory suggests that the democratization of safeguard remedies would encourage and attract the involvement of opportunistic participants in the political market, while giving rent-seeking interest groups and lobbyists excessive influence in the decision-making process. It is true that “[t]he case in favor of economic openness must be made and won at home,”\textsuperscript{321} but it would likely be quite problematic to add democratic-procedure requirements to each individual trade issue of any consequence regarding the potential use of safeguard remedies.

The potential losers in any given scenario—individuals, firms, groups and communities impacted by certain issues—can be expected to spare no effort or expense in order to protect their interests. They will likely be best positioned to lead the democratic decision-making process. While most people in a given country may benefit from the liberalization of international trade laws in the long-term—and may come to support free trade over time—the fact that protests rallying against globalization and international trade are relatively commonplace serves to remind us that many individuals do not appreciate that overall long-term gain often requires short-term pain, most typically in the form of domestic job losses in affected sectors.

Rodrik fails to appreciate that democratization does not guarantee that a rational, long-term perspective will win the day. Public choice theory suggests that the public does not always incentivize elected leaders to act in the objective public

\textsuperscript{320} Ibid.
\textsuperscript{321} Ibid.
interest. Rather than allow prospective losers to dominate the decision-making process (with the result being inefficient and socially undesirable results), the action that would most greatly benefit society on net should be adopted to ensure that a country’s long-term interests are pursued; losers should be compensated so that they will not oppose a decision that is best for the rest of the country. Short-term inefficiencies—in essence, mitigation plans intended to deal with the losers—are far preferable to long-term inefficiencies, though voters concerned with the “here and now” may not recognize this. This reality represents a significant problem with Rodrik’s proposal to turn trade issues into de facto popularity contests. Democratization merely encourages actors—both voters and politicians—to focus on the short term, largely overlooking long-term considerations.

Secondly, an emphasis on democracy is ethnocentric and is hardly in keeping with a global perspective, which is problematic for a truly global—and consequently very diverse—organization like the WTO. Many developing countries are unlikely to be considered “democracies” in the western sense. Tying democratic-procedure criteria to the use of safeguards would surely aggravate China, most significantly, as well as several other developing nations, including Kenya, Nigeria, Egypt, Pakistan, and former members of the Soviet Union. Furthermore, there is nothing inherent in democratic procedures to suggest they lead to economically efficient systems and decisions. Additionally, Trebilcock and Prof. Mariana Mota Prado note that “[d]emocracy is not

always viewed as being conducive to promoting development.”\textsuperscript{324} While the empirical evidence is ambiguous, some studies show that more authoritarian regimes may actually be more conducive to economic development than democracy, at least in the early stages of development.\textsuperscript{325} Limiting the use of safeguards to countries that show a particular level of democracy would be damaging to the most vulnerable developing states—and these are the countries that would likely be in the most need of temporary protectionist measures to foster industrial growth.\textsuperscript{326}

Thirdly, while Rodrik argues—correctly, in my view—that “[a]n extension of safeguards to cover environmental, labor, and consumer safety standards or developmental priorities at home...would increase the legitimacy and resilience of the world trading system and render it more development-friendly,”\textsuperscript{327} he fails to offer meaningful recommendations for ensuring that countries do not abuse opt-out clauses on these grounds. Widening safeguards to apply to these areas is a slippery slope, and it is important to attempt to guarantee that countries do not simply pick and choose to engage in free trade in industries that benefit domestic firms. If trade commitments cease to be credible, they will not be made in the first place. The basic theory of competitive advantage—the driving force behind international trade—stipulates that “a country should specialize in producing and exporting goods in which its comparative advantage is greatest, or comparative disadvantage is smallest, and should import goods in which its comparative disadvantage is greatest.”\textsuperscript{328} With the possibility of occasional temporary exceptions to this general proposition in favour of fostering the

\begin{itemize}
\item \textsuperscript{325} Ibid at 126-128.
\item \textsuperscript{326} Ibid at 126-131.
\item \textsuperscript{327} Rodrik, supra note 14 at 255.
\item \textsuperscript{328} Trebilcock, \textit{Understanding Trade Law}, supra note 134 at 3.
\end{itemize}
growth of infant industries, states benefit—on net—from focusing on what they do best and importing goods and services in areas where it would be more efficient for them to do so. An alternative to protectionist measures would be to ensure that trade law requires all costs associated with production, processing, and distribution to be internalized, so that externalities do not negatively impact international trade as a whole; this means that market forces could be used to “protect” the areas that Rodrik mentions—environmental, labour, and consumer safety standards—so that market interference, in the form of escape clauses, is unnecessary. Forced to account for all necessary factors (including possible environmental concerns and health and safety considerations), actors would be incentivized to act in rational, socially responsible ways.

Fourthly, Rodrik suggests shifting from a temporary approach to safeguard measures to one that permits more permanency, perhaps with periodic review of the measures or imposing sunset clauses “that could be revoked in case the problem continues.” While allowing for more flexibility than the current agreement permits would be an improvement, as it would enable states to better tailor measures to individual problems, it is important to recognize that safeguards should typically be transition-focused, aimed at temporarily easing the burden for the negatively impacted parties with the ultimate goal of reaching a sustainable solution for all involved.

While Rodrik is correct to argue for a significant expansion to the safeguards regime, his proposed plan is short on details. Based on his descriptions to date, Rodrik’s proposals seem to be afflicted with poor institutional design, and, if implemented as

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329 Rodrik, supra note 14 at 256.
330 Rastorp, supra note 256 at 174.
331 Ibid.
they are now, would threaten to unravel key advances that have been made in the field of international trade law to date.

**Basic Blueprint for a New and Expanded Safeguards Regime**

It is vital to ensure that a new WTO safeguards regime would allow for a smoothing out of the economic instabilities that can result from a liberalized international trade system rather than a smothering of international trade. Nevertheless, the strength of Rodrik’s proposal is the flexibility it affords countries; it will be especially important for developing countries to have the ability to tailor development strategies and policies to their particular circumstances. Thus, while I agree with Rodrik that it is necessary to expand the use of safeguards to a number of new areas, I argue that there must be clear guidance as to when it would be appropriate to employ safeguard measures. Simply entrusting “democracy”—in the domestic sense—to ensure the health of the WTO trade regime is insufficient.

The points made by Sykes and Rastorp regarding potential theoretical rationales for the presence of a WTO safeguards regime must be borne in mind; an understanding of what we are attempting to accomplish is key. Otherwise, we risk making the design of a new safeguards regime an exercise in futility (or worse). Assuming that an escape clause is justified because of relevant political economy concerns, it is important to ensure that the safeguard measures assist in addressing these concerns.

The current safeguards system is overly restrictive, as it requires that five main elements must be demonstrated before safeguard measures can be adopted: 1) there

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<sup>332</sup> Please see discussion at pages 47-53, above.
must be unforeseen developments; 2) there must be prior trade obligations or concessions; 3) the first two elements must be shown to lead to an increase in imports; 4) there must be serious injury or the threat of serious injury; and, 5) the first three factors must be proven to cause a significant portion of the serious injury.333 These criteria mean that safeguards may only be used in very set and limited circumstances, but as the most plausible theoretical rationale for the existence of safeguards puts emphasis on a diverse set of political economy factors, a new safeguards regime should be sufficiently flexible to adapt to various scenarios.

Firstly, I concur with Sykes that the unforeseen developments requirement ought to be eliminated. There are many reasons supporting this, but the major issue is that whether or not developments are foreseen is irrelevant in assessing the consequences facing a country.334 Furthermore, Prof. Sheela Rai from the Hidayatullah National Law University states that the unforeseen developments requirement “makes valid imposition of safeguard measures almost impossible,”335 and this problem “becomes more acute for the developing countries, many of whom might not be able to perform the econometric analysis that becomes necessary.”336

Secondly, I propose removing the provision requiring that safeguards may be used only to address increases in imports. I agree with Rodrik that the WTO should welcome the fact that “countries may wish to restrict trade or suspend WTO obligations...for reasons other than a competitive threat to their industries.”337 Safeguards should be used as a sort of “catch-all” category, given the diffuse nature of

333 Trebilcock, Understanding Trade Law, supra note 134 at 302; Trebilcock, Howse & Eliason, supra note 11 at 414.
334 Rastorp, supra note 256 at 138.
335 Rai, supra note 267 at 205.
336 Ibid.
337 Rodrik, supra note 14 at 253.
the political economy concerns that make this type of remedy necessary. Limiting the use of safeguards to increased imports is unreasonably restrictive. There must be greater flexibility available to states in the use of safeguards if these are to prove to be useful tools that ultimately make the liberalized system of international trade stronger. As Rodrik states, "Less flexible rules do not necessarily make better ones."

Instead, they “increase the risk that governments will find their hands tied in circumstances where it would have been desirable for them to act,” which “may therefore reduce, rather than increase, the value of trade agreements and diminish the incentive to sign on to them.” Flexibility is needed in order to avoid these issues.

Thirdly, I suggest eliminating the serious injury requirement. The meaning of this requirement is uncertain and it also suggests a bias toward protecting previously strong industries. Instead, for the benefit of developing countries in particular, this should be eliminated, so that safeguards could more easily be applied in infant industry scenarios, which is in keeping with Article XVIII of the GATT. This would be consistent with the WTO’s (apparent) commitment to support “the economic development of developing countries through expansion of their share in international trade” and with the GATT’s “[endorsement of] the promotion of ‘infant’ industries of developing countries for their economic development.” As Lee states, “[S]afeguards can provide the necessary protection for infant industries from the surges of imports that may endanger their positions in their domestic markets” and their overall development.

Fourthly, the rather baffling causation requirement should be abolished. This

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338 Ibid at 258.
339 Ibid.
340 Ibid.
341 Lee, supra note 248 at 196.
342 Ibid.
343 Ibid at 198.
clearly flows from my proposed amendments above; if we are to greatly expand the number of possible uses for safeguard measures, the current causation obligation becomes obsolete. (It is also worth noting that it is nearly impossible to isolate and assess injuries resulting from different causes because many causes are interrelated.344

Fifthly, I recommend relaxing the non-discrimination requirement associated with the use of safeguards, so as to allow for improved “targeting” of these measures. Permitting states to tailor safeguard measures to countries that represent the most significant threats to economic development would increase the effectiveness of safeguards while also reducing the negative economic effects experienced by other countries that are, at present, caught up in the measure.345 China’s undervaluation of its currency creates a trade imbalance that affects the US (and a number of other countries). The US ought to be able to implement a safeguard measure targeted precisely at China; it should not be forced to employ such a measure against all of its trading partners.346

At this point, it may seem that I am suggesting an unchecked “free-for-all” regarding the use of safeguard measures. The question becomes, without many of the current restrictions with respect to the use of safeguards, how would the WTO prevent countries from abusing this escape clause? The answer lies within the compensation clause regarding the use of safeguards.

The current safeguards regime contains a built-in suspension-of-retaliation clause; this is intended to act as an incentive for states to apply safeguards for only a

344 Sykes, supra note 246 at 252-253.
345 Rodrik, supra note 14 at 256.
346 Ibid at 276-278.
short period of time.\textsuperscript{347} A country can avoid the obligation to compensate states negatively impacted by the implementation of a safeguard by proposing that the safeguard will not endure for longer than three years.\textsuperscript{348} This exception must be abolished—or at least substantially reduced—so that countries adopting safeguards are forced to cover a significant portion of the costs associated with their trade-distorting actions.\textsuperscript{349}

I concur with Lee’s position that “compensation should be required prior to the application of a safeguard”\textsuperscript{350} in most cases because this deters states from abusing safeguards. As Prof. Petros Mavroidis of Columbia Law School explains, this compensation typically takes the form of “concessions in another product market for loss of market shares in the product market where a safeguard is being taken,”\textsuperscript{351} meaning that “a member imposing safeguard measures has to pay for offering this protection to its domestic industry.”\textsuperscript{352} He states, “The obligation to compensate...corresponds to the idea that safeguards might improve national welfare, but have detrimental effects on global welfare: compensation must thus be paid to affected parties in order to ensure that the effect of beggar thy neighbour policies is minimized.”\textsuperscript{353}

Mandatory and immediate compensation for using safeguards is vital to preventing abuses. It would be possible to allow for much greater flexibility with regard to the circumstances in which safeguards may be instituted, provided that the use of

\textsuperscript{347} Lee, \textit{supra} note 248 at 198.
\textsuperscript{349} Ibid.
\textsuperscript{350} Lee, \textit{supra} note 248 at 198.
\textsuperscript{351} Mavroidis, \textit{supra} note 348 at 376.
\textsuperscript{352} Ibid [emphasis in original].
\textsuperscript{353} Ibid at 377 [emphasis in original].
safeguards is tied to immediate mandatory compensation (to a level that very nearly makes up for any losses) for countries negatively impacted by these measures. This approach would effectively amount to the WTO telling countries, “Sure, you can protect this area (temporarily), but what is it worth to you? There is no such thing as a free lunch.” Compelling countries to compensate others—without delay—for losses flowing from the use of safeguards forces political leaders to approach safeguard decisions as they would other domestic political decisions regarding redistribution. This is hugely beneficial because externalities stemming from the use of safeguards (effects on global welfare and the costs associated with disrupting trade patterns) are therefore—at least for the most part—internalized. As such, the argument can readily be made that consenting parties should be allowed to contract more or less as they wish, so long as third parties are not (significantly) negatively impacted—at least without having received sufficient compensation.

Furthermore, the temporary nature of safeguards ought to be emphasized in order to deter the abuse of opt-outs. A short term, like the current four-year limitation (which in some cases can be renewed for an additional four years), should remain intact. Further studies must be conducted to determine an appropriate duration, but the somewhat-arbitrary existing limit may be sufficient. I would also propose retaining the obligation to progressively liberalize safeguard measures at regular intervals over the period of application.\textsuperscript{354} It would likely be wise to establish a somewhat longer period of application for developing countries—or those deemed to be the least-developed countries—but this should not be dramatically longer, as this would risk continuing dependence on protectionist measures; we must remember that safeguards are meant

\textsuperscript{354} Agreement on Safeguards, supra note 205 at Article 7.4.
to ease transitions in order to improve trade in the long term—not to obstruct or suffocate trade.

With my proposal, WTO Panels and the Appellate Body would have jurisdiction over ensuring that parties involved in disputes concerning safeguards adhere to the compensation requirements and duration limits outlined. In this regard, these bodies would act more or less as arbitrators; there would no longer be emphasis on the technical concerns that have essentially prevented the use of safeguards to date (measuring increases in imports, assessing injuries, determining causation, etc.).

My proposal is intended to offer a basic blueprint for designing a new safeguards regime; it is not meant to be a ready-to-use system. Certainly, each part of my proposal must be evaluated in more depth before a new safeguards regime could be adopted, and such an evaluation is beyond the scope of this paper.

Placing emphasis on the internalization of costs associated with the disturbance and distortion of international trade stemming from the use of safeguards should assist in deterring the abuse of opt-outs, which otherwise would be problematic in a system that permits the use of safeguards in a variety of scenarios. As Rodrik argues, "If mechanisms explicitly designed to facilitate protectionist barriers, such as the anti-dumping rules of the GATT, have not destroyed the multilateral trade regime thus far, it is not clear why well-designed exit clauses would have consequences that are worse."\(^\text{355}\)

Efficacy of New Safeguards Regime in the Context of Renminbi Undervaluation

A new and expanded safeguards regime that follows the general blueprint outlined in this paper should be quite effective in the context of a currency-

\(^{355}\) Rodrik, supra note 14 at 258.
undervaluation situation. In order to address the economic consequences flowing from China’s strategy of undervaluing the renminbi, the US could implement safeguard measures under this new regime in order to protect its most vulnerable industries. This would be a much easier exercise than under the existing system.

With the removal of the unforeseen developments requirement, the US would not find itself mired in a convoluted—and irrelevant—analysis of foreseeability. This eliminates an arbitrary and often unpredictable obstacle to the use of safeguard remedies.

Without the provision stipulating that safeguards be used only to address situations where increases in imports can be shown, the process of safeguard implementation is further streamlined. It would no longer be necessary to incur the measurement costs associated with import volume assessments, and delays related to the need for empirical studies of this nature would be eliminated, meaning that safeguards could be used in a more proactive—and less reactive—manner. The US would be free to expand safeguard remedies to industries that have not yet been impacted by the consequences stemming from China’s currency policy, preventing damage before it is done. Similarly, without the need to demonstrate actual or potential serious injury prior to the implementation of safeguards, the US would be able to be proactive in acting to address anticipated consequences of Chinese currency undervaluation without having to wait for declines to take place. Additionally, because of the elimination of the increased imports and serious injury requirements, it would no longer be necessary for the US to prove causation with regard to safeguards implemented to address concerns relating to the renminbi’s undervaluation. Causation
has historically been a significant obstacle to the use of safeguard remedies,\(^\text{356}\) and the elimination of causation studies would significantly simplify the process of safeguard implementation.

Without the non-discrimination principle in effect, the US could implement safeguards that are tailored to specifically address concerns relating to Chinese currency undervaluation. This is beneficial, as it allows the US to “target” China without having to implement similar safeguard measures against other trading partners. However, the US would not have a free pass to discriminate against China; the American government would be obligated to compensate China in advance of instituting any safeguards. For instance, if the US wanted to protect its manufacturing sector from concerns relating to the undervaluation of the renminbi, it would have to offer China “concessions in another product market for loss of market shares in the product market where a safeguard is being taken,”\(^\text{357}\) perhaps in an area like natural resources, such as the importation of lumber. Although the American government could move to temporarily protect the US manufacturing sector, it would risk upsetting domestic firms involved in the forestry sector in this example. The US government would thus be forced to make both domestic- and international-level political calculations prior to acting. This would ensure that the US has the flexibility to act to temporarily protect its most important interests, but it must bear the costs associated with disrupting international trade by adopting safeguard measures; this disincentivizes the use of beggar thy neighbour policies, ensuring that—in the long run—the arc of the global economy bends toward free trade.

The new safeguards regime would still be industry-specific, meaning that the US

\(^{356}\) Trebilcock, Howse & Eliason, supra note 11 at 416-417.

\(^{357}\) Mavroidis, supra note 348 at 376.
would have to institute a series of separate (but related) safeguard measures in order to cover different industries. However, as discussed,\(^{358}\) this would be a more realistic and practical option under the new system, as causation studies and many other empirical-analysis requirements are removed.

It should also be noted that the existence of a flexible and expanded safeguards regime would have the potential to prevent significantly trade-distorting situations—such as intentional currency undervaluation—from occurring in the first place. If a flexible safeguards system had been in place at the time China joined the WTO, the Chinese government could have implemented a series of tailored safeguards in order to temporarily protect its most important industries. This would have allowed China to continue to pursue policies that focused on the rapid expansion of industrialization\(^{359}\)—shielding certain domestic industries from international competition for a period of time—without forcing the Chinese government to resort to a severely trade-distorting policy of currency undervaluation.\(^{360}\)

**VI. Conclusion**

Rodrik argues, “When trade ministers get together, they should talk about expanding the maneuvering room for individual nations rather than narrowing it further.”\(^{361}\) Bargaining that focuses on “policy space rather than market access...would benefit rich and poor nations alike.”\(^{362}\) As Rai notes, in recent years, it has been primarily developing countries that have implemented safeguards;\(^{363}\) this implies that

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\(^{358}\) Please see discussion at pages 61-67, above.  
\(^{359}\) Rodrik, *supra* note 14 at 275.  
\(^{360}\) *Ibid* at 276.  
\(^{361}\) *Ibid* at 253.  
\(^{362}\) *Ibid*.  
\(^{363}\) *Rai*, *supra* note 267 at 203.
“developing countries are mastering the art that the developed countries have hitherto used...of making effective use of protective clauses to ensure the good health of their domestic industries.”364 But this is a two-way street; as Lee explains, “For developing countries that depend on exports for their economic development, safeguards, particularly those applied in their major export markets, may significantly hamper their exports and development.”365

Until recently, it would have been quite difficult to convince developed countries to negotiate a new agreement regarding safeguards; after all, increasing the use of safeguards could be seen to chiefly benefit developing states.366 However, concerns regarding the undervaluation of Chinese currency may prompt developed countries—led by the US—to encourage a reexamination of the Agreement on Safeguards. The US has suffered numerous negative economic and political effects due to the trade imbalances flowing from the undervaluation of the renminbi, and, thus far, notwithstanding these injuries, the US seems to have largely lacked effective recourse under international trade law.367 Implementing a new approach to safeguards such as the one recommended in this paper—which emphasizes flexibility and the internalization of costs flowing from the use of protectionist measures—would more or less say to members: “[Y]ou are entitled to your own growth strategy, but you also need to ensure that you do not produce large negative effects for the rest of the world in the form of trade surpluses”368 or other significant distortions.369 As Rodrik argues, “If China and other developing nations want their policy space, they will have to allow rich

364 Ibid.
365 Lee, supra note 248 at 196.
366 Rai, supra note 267 at 205.
367 Rodrik, supra note 14 at 277.
368 Ibid.
369 Ibid.
nations to have theirs as well.”

While this paper does not claim to give a detailed plan to overhaul the WTO safeguards regime, I believe that, if a comprehensive plan were to be designed based on this straightforward blueprint, a flexible safeguards regime could be created to address a variety of political economy issues. In contrast to an approach that focuses on redesigning the safeguards regime, other scholars, such as Wentong Zheng of the University of Florida, have advocated for an integrated trade remedies regime, which would essentially combine antidumping remedies and safeguard measures and also eliminate the need for countervailing duties. Zheng, for instance, envisions “[replacing] antidumping with a country-specific safeguard equipped with a heightened injury standard and a mandatory public interest requirement.” However, Zheng’s proposed system focuses on injury determinations; in fact, his proposal calls for the use of a higher injury standard than antidumping remedies currently require. Additionally, there would be a strong—though not fully explained—public interest component to the imposition of safeguards, similar to Rodrik’s proposal. Moreover, consistent with the current antidumping approach, Zheng’s proposal would not feature any compensation requirement.

In reality, the basic blueprint outlined in my paper may significantly reduce both antidumping actions and the use of countervailing duties. However, I am leery of Zheng’s recommendation to eliminate these other remedies entirely, as situations may arise where, for instance, countervailing duties would be appropriate in addressing explicit subsidies. The primary flaw with Zheng’s approach is the reliance on a set of

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370 Ibid at 278.
372 Ibid at 183-185.
373 Ibid at 177-181.
374 Ibid at 188.
rules and standards (especially a higher injury standard), which must be adjudicated by the WTO. My suggestion, on the other hand, is quite simple; by employing a compensation mechanism—calling for mandatory and immediate matching concessions to be made to targeted countries in exchange for the ability to impose safeguards—countries are forced to internalize costs relating to their trade-distorting actions. Governments will be forced to face the music for their own redistributive decisions in the domestic political arena, rather than offload costs—trade-related externalities—associated with domestic-industry-pandering actions to their international trading partners. This would deter states from instituting beggar thy neighbour policies, and it would greatly simplify the process for implementing trade remedies.

If designed effectively, again with an emphasis on internalizing costs using a compensation mechanism, this new safeguards regime would not pose substantial risk to trade overall. Any outstanding losses borne by other countries—which would be minimized as a result of the compensation requirement—due to the adoption of safeguard measures would “be a small price...to pay for preserving an open global economy overall.”

Rodrik states that any trade restraints stemming from a revised safeguards regime ought to be taken “in stride—not as instances of protectionism that it needs to fight tooth and nail, but as necessary exercises in system maintenance.”

In sum, I have identified four possible approaches the US may take to contend with China’s practice of undervaluing the renminbi: 1) a challenge under Article XV of the GATT and the associated IMF provisions relating to currency manipulation; 2) the implementation of countervailing duties as a response to Chinese currency practice

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375 Ibid.
376 Ibid.
377 Trebilcock, Howse & Eliason, supra note 11 at 233-236.
viewed as an export subsidy;\(^\text{378}\) 3) an argument that the antidumping provisions of the GATT would prohibit China’s actions;\(^\text{379}\) and 4) a response under the GATT emphasizing the use of safeguard remedies.\(^\text{380}\) As discussed, the first three approaches are unlikely to succeed; there are a number of legal and political obstacles to the pursuit of these remedies. While the current WTO safeguards regime is likely insufficient, a new safeguards regime can—and should—be developed. All WTO members would stand to benefit from a more flexible approach to safeguards; somewhat paradoxically, flexibility in the realm of international trade law would help to secure a large degree of overall stability in international trade itself. This is vital in order to ensure the long-term health—indeed, the very survival—of the WTO and of global economic structure more generally. In order to be effective shock absorbers, safeguards must become far more flexible.

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\(^{378}\) Trebilcock, *Understanding Trade Law*, supra note 134 at 84-85; Trebilcock, Howse & Eliason, *supra* note 11 at 33-34.

\(^{379}\) Li, *supra* note 13 at 78-79.

\(^{380}\) Rodrik, *supra* note 14 at 276-278.
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