REGIONAL FOCUS & CONTROVERSIES

Japan's Unspoken Currency Manipulation by Monetary Policies: A Chinese Lawyer's Perspective

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During the past few years, the Bank of Japan has injected billions of yen into the economy and pursued a monetary easing policy. Japan has plausible arguments, namely that its current policies are needed to support the growth of the economy and to spur inflation. However, these measures result in a weakened yen and increase trade imbalances between Japan and other Asian countries, particularly China. This article argues that Japan's practice is rooted in protectionism and examines such actions under the IMF Agreement and the WTO system. It is suggested that the Chinese government should adopt diplomatic and judicial approaches to urge Japan to return to normal monetary policies.

Keywords

Devaluation, Yen, Quantitative Easing Policies, Exchange Rates Manipulation, IMF, WTO

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1. Introduction

Since Shinzo Abe became prime minister of Japan on December 26, 2012, the Bank of Japan ("BoJ") has introduced a series of economic reform to correct its current economic recession.[1] As traditional monetary policies have limits in combating recession and deflation, Japan turned to a radical quantitative easing policy aimed at depreciating the Japanese yen. These measures have resulted in substantial depreciation of the yen *vis-a-vis* other currencies. The depreciation of yen has helped to bolster Japanese exports, but is at the expense of Japan's trading partners.

While there are many commentaries on this issue, most of which focus on economic or political implications.[2] This research, however, will provide an in depth analysis of whether Japan's policy could be challenged under relevant international treaties including the IMF Agreement, Article XV of the GATT 1994, or the Subsidies and the Countervailing Measures Agreement [hereinafter SCM Agreement]. It will discuss what kinds of remedies would be available if Japan has violated any of its international responsibilities. This paper is composed of five parts including Introduction and Conclusion. Part two will provide background on Japan's monetary policies and the criticisms against them. Part three will examine the rules and regulations under the IMF that govern the 'exchange arrangements' and "exchange rate policies." Part four will clarify the relationship between exchange rates and international trade, as well as the question of what arguments can be given to Japan's quantitative easing as a measure that may impair the commitments made in trade agreements, particularly the WTO rules. Part five will suggest political and legal strategies to encourage a change in Japan's monetary policies.

1 D. Pilling, *Premise of Shinzo Abe's Economic Plan is that 15 Years of Deflation Have Sapped Japan's 'Animal Spirits,'* Financial Times, Jan. 2, 2014, *available at* http://www.ft.com/intl/cms/s/0/c26bc078-673d-11e3-a5f9-00144feabdc0.html#axzz2ws0OYKqB (last visited on Apr. 17, 2014).

2 *See generally* Bonkwan Koo, *Abenomics, Finally a Solution to Revive Japan?*, 6 SERI Q. 30 (2013); A. Field, *Japan's Three-Arrow Attack*, 14 J. Com., 19 (2013); A. Pereira & S. Allard, *Recent Development: Looking to Fill an International Regulatory Gap: Brazil Brings the Issue of Exchange Rates and Trade Before the World Trade Organization*, 26 Emory Int'l L. Rev. 535 (2012).

2. Japan's Current Monetary Policies and their Effects on the International Market

Since the collapse of the stock market and real estate prices in the 1990s, the Japanese economy has fallen into its deepest recession in the postwar period, also known as "The Lost Decade."[3] On March 19, 2001, the BoJ embarked on a quantitative easing policy to stimulate the nation's stagnant economy.[4] As the first time in Japan's history, this unconventional policy took the following measures. First, it adopted and maintained the so-called zero rate commitment as long as deflation continued. Second, the BoJ had supplied more bank reserves than necessary to maintain the short-term interest rate at zero from March 2001 until early 2006.[5] This strategy, however, was ended in 2006 without any favorable result. Quantitative easing, i.e., increasing liquidity into the financial sector, by itself, proved insufficient to stimulate the economy or revive inflation.[6]

After the 2007-2009 financial crisis, several central banks of developed countries, including the US Federal Reserve, began to pursue quantitative easing policies to stimulate economic growth.[7] The BoJ took similar aggressive measures. On September 15, 2010, Japan first intervened into the currency markets by selling large amounts of yen, driving the currency plunge sharply.[8] Although the Japanese finance minister stated the BoJ's intervention was aimed at stabilizing the market rather than weakening the yen *per se*,[9] Peter Tasker, an analyst at Arcus Research in Tokyo said: "The intervention was the first sign that the government was being

[3] *See Monetary Policy and the Lost Decade: Lessons from Japan*, IMF Working Paper (WP/09/232), Oct. 2009, *available at* http://www.imf.org/external/pubs/ft/wp/2009/wp09232.pdf (last visited on Apr. 17, 2014).

[4] *See Japan Cuts Rates to Zero*, BBC News, Mar. 19, 2001, *available at* http://news.bbc.co.uk/2/hi/business/1228152.stm (last visited on Apr. 17, 2014).

[5] Nobuyuki Oda & Kazuo Ueda, *The Effects of the Bank of Japan's Zero Interest Rate Commitment and Quantitative Monetary Easing on the Yield Curve: a Macro-Finance Approach*, 58 The Japanese Econ. Rev. 303 (2007).

[6] E. Girardin & Z. Moussa, *Quantitative Easing Works: Lessons from the Unique Experience in Japan 2001-2006*, 21 J. International Financial Markets, Institutions and Money 461- 462 (2011).

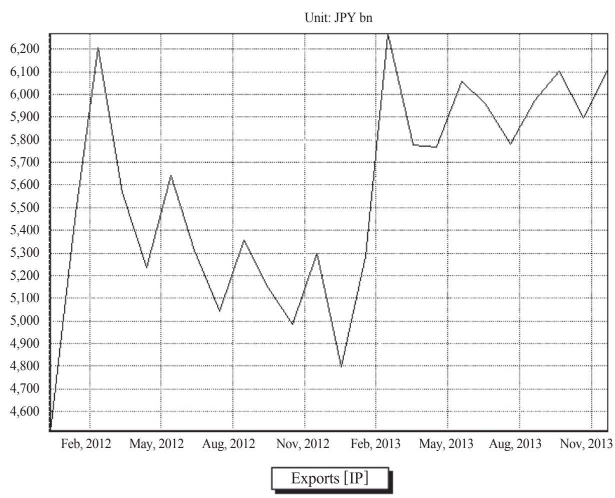
[7] J. Kay, *Quantitative Easing and the Curious Case of the Leaky Bucket*, Financial Times, July 9, 2013, *available at* http://www.ft.com/intl/cms/s/0/6b0d5268-e7ba-11e2-babb-00144feabdc0.html#axzz2z8NUaWWC (last visited Apr. 17, 2014).

[8] C. Cooper & P. Eckert, *Japan Intervenes to Weaken Yen, More to Come*, Reuters, Sept. 15, 2010, *available at* http://www.reuters.com/article/2010/09/15/us-japan-economy-intervention-idUSTRE68E0AE20100915 (last visited on Apr. 17, 2014).

[9] Michiyo Nakamoto, *Japan Finance Chief Defends Yen Intervention*, Financial Times, Oct. 8, 2010, *available at* http://www.ft.com/intl/cms/s/0/6a5d13ca-d292-11df-9e88-00144feabdc0.html#axzz2z8NUaWWC (last visited on Apr. 17, 2014).

proactive, was dissatisfied and was prepared to do something about it."[10] In fact, this unilateral intervention marked a further easing of monetary policy.[11] On January 22, 2013, under the relentless pressure of Prime Minister Shinzo Abe, the BoJ announced its most determined effort to end years of stagnation by economic survival plan.[12] This decision to adopt an open-ended asset buying program and double its inflation target exceeded market expectations.[13] After one year since introducing the so-called Abenomics to reinvigorate the Japanese economy, Japanese exports rose by volume from a year earlier. (Figure 1)

Figure 1: Japan Trade Statistics: Exports from January 1, 2012 to December 31, 2013[14]



On December 20, 2013, less than 48 hours after the Federal Reserve System plan to withdraw the quantitative easing monetary policy that has been in place to support economic growth after the crisis, the BoJ's board said it would aggressively continue to purchase bonds until achieving a stable 2 percent rate of consumer price inflation,

10 L. Whipp, *Tokyo's Yen Intervention Heralds Shift in Attitude*, Financial Times, Sept. 20, 2010, *available at* http://www.ft.com/intl/cms/s/0/2b5a78fa-c4de-11df-9134-00144feab49a.html#axzz2tDY2opQL (last visited on Apr. 17, 2014).

11 L. Whipp & M. Dickie, *Yen Intervention Draws European Criticism*, Financial Times, Sept. 15, 2010, *available at* http://www.ft.com/intl/cms/s/0/43627416-c074-11df-8a81-00144feab49a.html#axzz2tQUf9yj3 (last visited on Apr. 17, 2014).

12 Leika Kihara & Tetsushi Kajimo, *Bank of Japan in Boldest Attempt Yet to Revive Economy*, Reuters, Jan. 22, 2013, *available at* http://www.reuters.com/article/2013/01/22/us-japan-economy-boj-idUSBRE90K08J20130122 (last visited on Apr. 17, 2014).

13 *Id.*

14 *See* CEIC, *available at* http://webcdm.ceicdata.com (last visited on Apr. 18, 2014).

reiterating its commitment to maintaining current stimulus levels.[15]

A. Response of Neighboring Countries

Although the Japanese government highly appreciated the BoJ's decision to switch to an open-ended easing policy,[16] this new activism spread uneasy feeling largely in Europe and developing countries.[17] The officials in these regions have warned publicly and privately about the possibility of a 'currency war' of competitive devaluations.[18] It was also criticized by the US, which introduced a similar macroeconomic policy to foster the economy. The American Automotive Policy Council's President Matt Blunt stated in May 2013 that: "The depth of Japanese currency manipulation has reached a new low. Japan's monetary policies aimed at weakening the yen continue to boost Japan's economy and exports at the expense of its trade partners, especially the US"[19] The US Secretary of Treasury Jack Lew claimed that Japan had 'growth issues' to be dealt with, but it needed to stay within the bounds of international agreements to avoid competitive depreciation.[20]

Elsewhere in Asia the responses were more tit for tat, given that Japan was both major destination for their exports and a strong competitor in the US and European markets. China and South Korea's anxiety over the rapidly falling yen came to the fore, as senior officials said their exporters could be hurt by Japan's attempts to pull its moribund economy out of a two-decade's slump.[21] *E.g.*, China's Commerce Minister Chen Deming worried that Japan's macroeconomic performance implied the "oversupply of money" and would slow down the sustained sound economic

15 B. McLannahan, *Bank of Japan Pledges to Maintain Easing Policy*, Financial Times, Dec. 20, 2013, *available at* http://www.ft.com/intl/cms/s/0/918e8b22-6925-11e3-bb3e-00144feabdc0.html#axzz2rkyiA1Fe (last visited on Apr. 17, 2014).

16 *See Japan Government Welcomes BOJ Easing Steps towards 2 Percent Inflation*, Reuters, Jan. 22, 2013, *available at* http://www.reuters.com/article/2013/01/22/us-japan-economy-govt-boj-idUSBRE90L07720130122 (last visited on Apr. 17, 2014).

17 J. Soble & B. McLannahan, *Aso Defends Japanese Currency Moves*, Financial Times, Feb. 12, 2013, *available at* http://www.ft.com/intl/cms/s/0/3af1fcac-74fe-11e2-8bc7-00144feabdc0.html#axzz2rOm4w6KA (last visited on Apr. 17, 2014).

18 *Id.*

19 E. Francis, AAPC Statement on Japan's Currency Hitting 100 Yen to the U.S. Dollar, Automotive Industries, May, 2013, *available at* http://www.ai-online.com/Adv/Previous/show_issue.php?id=5464&search=true#sthash.OwXgGFuU.dpbs (last visited on Apr. 17, 2014).

20 Leika Kihara and W. Schomberg, *U.S. Sends Japan Currency Warning as G7 Meets*, Reuters, May 10, 2013, *available at* http://uk.reuters.com/article/2013/05/10/uk-g-idUKBRE94817U20130510 (last visited on Apr. 17, 2014).

21 Jungmin Jang & Shinhyung Lee, *China, South Korea Alarmed as Yen Slide Threatens Exporters,* Reuters, Dec. 30, 2013, *available at* http://www.reuters.com/article/2013/12/30/us-asia-currency-idUSBRE9BT03A20131230 (last visited on Apr. 17, 2014).

growth.[22] In addition, officials of Korea warned that measures should be taken in response to the weaken yen.[23] The Korea's Vice Finance Minister Je-yoon Shin urged G20 nations to discuss the "adverse effects of monetary easing."[24]

B. Response of International Institutions

The quantitative easing policies adopted by Japan also drew the attention of the international community. Most concerns focused on the specific macroeconomic dynamics between exchange rates and foreign trade. On April 13, 2011, Brazil submitted a proposal within the WTO pointing out:

> Responses to the financial and economic crisis of 2008/09 have included the adoption, by a vast number of countries, of largely similar fiscal expansionist measures coupled with the lowering of interest rates. Yet, differently calibrated mixes of monetary and fiscal policy instruments have caused relative exchange rates among major trading partners to fluctuate frequently, with potentially different long-term impacts on their respective trade balances'.[25]

The WTO then established a work program under the Working Group on Trade, Debt and Finance [hereinafter Working Group] to deal with this issue. Based on the idea of global governance, the Working Group released a review of current study about global coherence of international trade and financial policies.[26] Members have submitted some thirty papers, references, and summaries of papers to the Secretariat, and the WTO Secretariat completed its review by September 27, 2011.[27] Then, an international seminar held by the Working Group took place on March 27-28, 2012.[28] While arguing in the seminar that there existed a relationship between exchange rates and trade flows, they pointed out that the key point of contemporary debate

[22] *See China Warns Japan on Currency Devaluation*, DEUTSCHE WELLE, Mar. 8, 2013, *available at* http://www.dw.de/china-warns-japan-on-currency-devaluation/a-16657634 (last visited on Apr. 17, 2014).

[23] Mitsuru Obe & A. Martin, *Japan Rebuffs Currency Manipulation Claims*, WALL ST. J., Jan. 25, 2013, *available at* http://online.wsj.com/news/articles/SB10001424127887323539804578263292820195934 (last visited on Apr. 17, 2014).

[24] *Id.*

[25] The Working Group, The Relationship Between Exchange Rates and International Trade: Submission by Brazil, WT/WGTDF/W/53 (Apr. 13, 2011), at 1.

[26] The WTO Working Group on Trade, Debt and Finance, The Relationship between Exchange Rates and International Trade: A Review of Economic Literature, WT/WGTDF/W/57 (Sept. 27, 2011), at 1.

[27] *Id.*

[28] The WTO Working Group on Trade, Debt and Finance, The Relationship between Exchange Rates and International Trade: Exchange-Rate Misalignment and Trade Remedies: A Conceptual Note by Brazil, WT/WGTDF/W/68 (Nov. 5, 2012), at 1.

has been shifting from exchange rate fluctuations to misalignments of exchange rates.[29] On November 5, 2012, Brazil filed another proposal to respond to the discussion, suggesting the WTO to discuss the systemic influence of exchange rate misalignments and craft new trade remedies to address currency misalignments.[30] Although the WTO hesitated to arrive at a definite conclusion, the Brazilian proposals still offer hints of progress in the arena of transnational regulation, and indicate an important conversation for the international community begins.[31]

The G20 is another premier forum for discussing, planning and monitoring international economic cooperation. During the 2010 Seoul Summit in South Korea, the G20 expressed its determination to resist protectionism.[32] The Declaration committed member countries to "undertake macroeconomic policies, to ensure on-going recovery and sustainable growth, in particular moving toward more market-determined exchange rate systems."[33] Unfortunately, at the finance ministers meeting in Moscow in February 2013, the G20 didnot name Japan for criticizing,[34] though the Communiqué required G20 members to notice the negative spillovers and externalities from monetary easing decisions implemented for economic stimulation, and refrained from competitive depreciation.[35]

On April 19, 2013, the G20 remained fairly cautious regarding Japan's policies at the Meeting held in Washington, D.C. The members agreed Japan's recent ultra-loose easing actions were intended to stop deflation and restart its economic.[36] Several economists weighed especially the argument of the international finance policy director of Korea Hee-nam Choi who stressed that: "the G-20 Communiqué did not involve and common consent that the members would tolerate the cheap yen. But the G20 seemingly clarified that Tokyo should not use monetary easing as a tactic to boost the country's exports by artificially depreciating the yen's value against major currencies but instead to only vitalize domestic demand."[37] After

29 *Id.*

30 *Id.* at 8-9.

31 Pereira & Allard, *supra* note 2, at 553.

32 G20 Information Centre, The G20 Seoul Summit Leaders' Declaration (Nov. 12, 2010), *available at* http://www.g20.utoronto.ca/2010/g20seoul.html (last visited on Apr. 17, 2014).

33 *Id.*

34 P. Inman, *G20 Meeting: Japan won't be Singled out for Currency Depreciation*, The Guardian, Feb. 15, 2013, *available* at http://www.theguardian.com/business/2013/feb/15/g20-meeting-japan-currency-wars (last visited on Apr. 17, 2014).

35 *See* Communiqué of Meeting of G20 Finance Ministers and Central Bank Governors at Moscow (Feb. 15-16, 2013), *available at* http://www.g20.utoronto.ca/2013/2013-0216-finance.html (last visited on Apr. 17, 2014).

36 *See* Communiqué of Meeting of G20 Finance Ministers and Central Bank Governors (Washington, D.C., Apr. 18-19, 2013), *available at* http://www.g20.utoronto.ca/2013/2013-0419-finance.html (last visited on Apr. 17, 2014).

37 Yonse Kim, *Seoul Denies G20's Backing of Cheap Yen*, The Korea Herald, Apr. 23, 2013, *available at* http://www.

reminding the risks of extended periods of easing monetary policy, the latest 2013 G20 Summit in St. Petersburg emphasized the stimulus of traditional monetary policies on strengthening and sustaining growth, and encouraged members to eventual ending the quantitative easing programs.[38]

3. Challenging Japan's Monetary Policies under the IMF Agreement

A. The Obligation under Article IV

Originally, the IMF was created to guard the fixed exchange rate arrangement called par value system.[39] As the dollar fixed-rate system adopted at Bretton Woods ended when President Nixon announced closing the window on dollar's convertibility into gold in 1971,[40] the IMF Members could peg their currencies against a specified currency of another member, or decide to freely float it in the market.[41] In other words, the IMF gave wider deference to the Members in choosing their exchange arrangements.[42] It is recognized that the government has the right to pursue sound economic policies and a country's exchange rate would reflect economic fundamentals.[43] However, there are still some restrictions to exchange rate policies, mostly available in Article IV of the IMF Agreement.

Article IV establishes the specific obligations for Members and the IMF with regard to 'exchange arrangements' and 'exchange rate policies.' The present version of Article IV was incorporated into the IMF Agreement by the Second Amendment in 1978.[44] This provision consists of a chapeau establishing a general obligation for

koreaherald.com/common_prog/newsprint.php?ud=20130423001028&dt=2 (last visited on Apr. 17, 2014).

38 *See* G20 St. Petersburg Summit Leaders' Declaration (Sept. 6, 2013), *available at* http://www.g20.utoronto.ca/2013/2013-0906-declaration.html#trade (last visited on Apr. 17, 2014).

39 IMF, Cooperation and Reconstruction (1944-71), *available at* http://www.imf.org/external/about/histcoop.htm (last visited on Apr. 17, 2014).

40 S. Ghizoni, Nixon Ends Convertibility of U.S. Dollars to Gold and Announces Wage/Price Controls, Nov. 22, 2013, *available at* http://www.federalreservehistory.org/Events/DetailView/33 (last visited on Apr. 17, 2014).

41 IMF Agreement art. IV, § 2(b).

42 IMF, Exchange Rate Regimes in an Increasingly Integrated World Economy, June, 2000, *available at* http://www.imf.org/external/np/exr/ib/2000/062600.htm (last visited on Apr. 17, 2014).

43 *Id.*

44 Article IV 1978 reads as follows:

> Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member

each IMF member to "collaborate with the IMF and other members," followed by a non-exhaustive catalogue of four specific obligations intended to give concrete meaning to the overarching obligation to collaborate.[45] It continues to reflect the view that a country's exchange rate policies are a matter of international concern.[46]

Compared to the original Article IV, the requirement to collaborate to promote 'exchange stability' was modified in the Second Amendment to promote a "stable system of exchange rates." The underlying assumption is still directed towards "financial and economic stability" and "facilitate the exchange of goods, services, and capital among countries," as indicated in the general obligations. However, the four specific obligations contained in Section 1 differ tremendously in nature. The first two obligations are signaled by cautious choice of words ('endeavor' or 'seek'), reflect that these obligations are 'soft.' On the contrary, Section 1(iii) establishes a 'hard' obligation that explicitly prohibits certain conduct.[47]

In order to adapt to the significant developments in the world economy, characterized by trade expansion and financial integration, the IMF issued an Executive Board Decision in 2007 to provide much clearer interpretation and guidance on what the Fund was supposed to focus on.[48] Although it creates neither additional nor stricter obligations than those contained in Article IV,[49] there are some points possibly related to Japan's recent situation.

1. External Stability

Paragraph 4 of the 2007 Decision provides:

> Members collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates [hereinafter systemic stability]. Systemic stability is most effectively achieved by each member adopting

undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall: (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances; (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions; (iii) 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; and (iv) follow exchange policies compatible with the undertakings under this Section.

45 C. Zimmermann, *Exchange Rate Misalignment and International Law*, 105 Am. J. Int'l L. 426 (2011).

46 IMF, Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework (June 28, 2006), at 15, *available at* https://www.imf.org/external/np/pp/eng/2006/062806.pdf (last visited on Apr. 18, 2014).

47 *Id.*

48 IMF, Bilateral Surveillance over Members' Policies-2007 Decision, June 15, 2007, *available at* http://www.imf.org/external/pubs/ft/sd/index.asp?decision=13919-(07/51) (last visited on Apr. 17, 2014).

49 *Id.*

> policies that promote its own 'external stability'… 'External stability' refers to a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements.[50]

The term 'external stability' also appears in Principle D. During the drafting of Principle D of 2007 Decision, it was proposed that fundamental exchange rate misalignment would be due to domestic reasons as well.[51] However, several negotiators argued that "Principle A focused on policies pursued for external purposes, the reference to domestic reasons should be understood as capturing all other objectives."[52] Thus, the final version of Principle D removes the term "fundamental exchange rate misalignment."[53] Consequently, when discussing Japan's easing policies, it is more feasible to refer to Principle A than Principle D, as one of the priorities of the former is "unfair competitive advantage."

2. *Exchange Rates Manipulation*

Principles A sets forth the obligation contained in Article IV, Section 1(iii). The 2007 Decision indicates that Principles B through D provide recommendations rather than obligations to members, while Principles A is an obligation.[54] In other words, it emphasizes the importance of Principles A. In fact, the Annex to the 2007 Decision provided some interpretative analysis:

> 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**.[55]

In order to find a member in breach of this provision, it is necessary to determine the existence of fundamental exchange rate misalignment and the intention of securing such misalignment. On June 22, 2009, a consultation paper of operational guidance

50 IMF Executive Board 2007 Decision, ¶ 4.

51 IMF Policy Development and Review Department and the Legal Department, Review of the 1977 Decision-Proposal for a New Decision, May 22, 2007, ¶ 16, *available at* http://www.imf.org/external/np/pp/2007/eng/nd.pdf (last visited on Apr. 18, 2014).

52 *Id.*

53 *Id.*

54 *Supra* note 50, ¶ 14.

55 *Id.* annex. [Emphasis added]

has referred to this question.[56] The IMF noticed that countries with floating exchange rate regimes do occasionally intervene in exchange markets. In such a case, Principle A addresses the issue of exchange rate manipulation and should be cited as the legal basis.[57] In addition, the consultation paper also pointed out that "a floating exchange rate could be under or overvalued as a result of domestic policies, even fully market determined exchange rates can result in disruptive adjustments."[58] That is to say, if a trading partner intervenes into the exchange rate by monetary policies that lead to a lower-than-market-based exchange rate, there is *prima facie* evidence of the IMF-defined exchange rate misalignment to gain an unfair competitive advantage.

It is not difficult to demonstrate that Japan's policies actually affect the level of the exchange rate between the Japanese yen ("JPN") and the Chinese Renminbi ("RMB"). During the past year of Abenomics, on December 30, 2013, 100 yen hit a low of 5.7884 RMB.[59] As currencies are permitted to vary in value in response to changing circumstance of the market, national officials could purchase or sell to influence the direction.[60] Likewise, it is widely accepted that many government policies can affect exchange rates by changing the supply or demand for domestic currency.[61] The situation also supported the fact that these measures unfairly ensured the competitiveness of Japan's exports. The China's Ministry's spokesman Danyang Shen said at a press conference that when RMB strengthened against JPN, China's exports to Japan declined.[62]

Then, the question comes to the intention behind Japan's quantitative easing program. Is it undertaken for the purpose of stimulating net exports, or in the pursuit of macroeconomic or development objectives? Japanese officials will of course deny that they are manipulating the yen and offer various alternative justifications. As stressed by the IMF, however, "the potential applicability of the obligation to avoid manipulation is constrained by the need to determine intent; this

56 IMF Strategy, Policy, and Review and the Legal Departments, The 2007 Surveillance Decision: Revised Operational Guidance (June 22, 2009), at 13, *available at* http://www.imf.org/external/np/pp/eng/2009/062209.pdf (last visited on Apr. 18, 2014).

57 *Id.*

58 *Id*. at 11.

59 China's State Administration of Foreign Exchange, Middle Exchange Rate of RMB, Dec. 30, 2013, *available at* http://www.safe.gov.cn/wps/portal/english/Home (last visited on Apr. 17, 2014).

60 R. Hockett, *Bretton Woods 1.0: a Constructive Retrieval for Sustainable Finance*, 16 N.Y.U. J. Legis. & Pub. Pol'y, 471(2013).

61 E. Posner & A. Sykes, *International Law and the Limits of Macroeconomic Cooperation*, 86 S. Cal. L. Rev. 1047 (2013).

62 *Yen's Depreciation Hits Chinese Exporters*, Xinhua, May 16, 2013, *available at* http://news.xinhuanet.com/english/business/2013-05/16/c_132387181.htm (last visited on Apr. 17, 2014).

determination is made independently by the Fund and is not based exclusively on the member's representation of its motives."[63]

B. The Function of Surveillance

Although the IMF was not given any special powers to enforce its policy advice to non-borrowing countries, it does have a measure of influence in the international community through its surveillance program.

1. Annual Surveillance

In order to implement Article IV of the IMF Agreement, the Fund exercises surveillance over the members' exchange rate policies through the so-called Article IV consultations between the Fund and its members. Article IV, Section 3(b) establishes a framework for the periodicity of consultations, which enables the Fund to monitor the exchange rate policies and provide advice tailored to the Members' circumstances. Article IV consultations may be held annually or, in any event, not longer than 24 months, depending on the member country.[64]

On July 31, 2013, the IMF Executive Board concluded an Article IV annual consultation with Japan.[65] Although the Directors agreed the assessment was in the wake of the recent changes in the macroeconomic policy framework of Japan, they took note of the staff's assessment that the exchange rate of yen was moderately undervalued.[66][67] The Directors also pointed out that: "financial and exchange markets were buoyant in early 2013 and the immediate aftermath of Quantitative and Qualitative Monetary Easing… As of end June, the yen has depreciated by about 20 percent in real effective terms since mid-2012."[68] At the same time, some Directors encouraged the authorities to "prepare plans for an eventual exit from quantitative and qualitative monetary easing."[69] These statements imply that the IMF was urging

63 *Supra* note 42, at 2.

64 Article IV Consultation Cycles (14747-(10/96)), Sept. 28, 2010, *available at* http://www.imf.org/external/pubs/ft/sd/index.asp?decision=14747-(10/96) (last visited on Apr. 17, 2014).

65 *See* IMF Executive Board Concludes 2013 Article IV Consultation with Japan, Press Release No. 13/296, Aug. 5, 2013, *available at* http://www.imf.org/external/np/sec/pr/2013/pr13296.htm (last visited on Apr. 17, 2014).

66 *Id.*

67 Here 'Directors' means 'required voting majority would be very comfortably satisfied if there were to be a vote, and all, or almost all, Directors can go along with the majority view'; 'Some Directors' means '5-6 of Executive Directors.' *See* Qualifiers Used in Summings up of Executive Board Meetings, *available at* http://www.imf.org/external/np/sec/misc/qualifiers.htm (last visited on Apr. 17, 2014).

68 *Supra* note 65.

69 *Id.*

Japan to give up current policies though no deadline was set.

2. Ad Hoc Surveillance

Another IMF program is *ad hoc* surveillance. The history of *ad hoc* consultations dated back to the 1977 Surveillance Decision.[70] It endowed the IMF with the monitoring responsibility when the Members' macroeconomic policies violate the exchange rate principles, but had never been activated before.[71] Consultation under the 1979 supplemental surveillance procedures was another informal and confidential discussion.[72] The surveillance would be initiated under the circumstance that important economic or financial developments of a Member were likely to affect its exchange rate related practice.[73] This procedure has been used only twice – Sweden in 1982, and Korea in 1987. Both cases concerned the issue of currency devaluation.[74]

Ad hoc consultation was again highlighted in the 2007 Decision. It specifies that whenever a member is found to distort its exchange rate due to the changing economic or financial status, the Managing Director should consult with the referred country.[75] The discussion is informal and confidential, and if the Executive Board determines it appropriate after considering the Managing Director's report, the ad hoc consultation will continue between the Executive Board and the Member.[76] Though the IMF was reluctant to undertake special surveillance in the past, the emphasis of *ad hoc* consultation in the 2007 Decision may be seen as a signal that the IMF is likely to fulfill its systemic responsibilities in future.[77] Japan's 'deflation' defense would not be entirely convincing to the IMF, the Fund may agree with China and other countries on this complaint. If the Japanese authorities refuse to abandon their quantitative easing policies, it is necessary for the Executive Board to start an *ad hoc* consultation with Japan and release a formal finding of breach of obligations under Article IV of the IMF Agreement.

70 C. Andrew & M. Goldstein, Strengthening the International Monetary System: Exchange Rates, Surveillance, and Objective Indicators (Occasional Paper No. 50) 21-33 (1987).

71 J. Boughton, Silent Revolution: The International Monetary Fund 1979-1989, 104 (2001), *available at* https://www.imf.org/external/pubs/ft/history/2001/ch02.pdf (last visited on Apr. 17, 2014).

72 IMF Exchange Arrangements and Surveillance (No. 6026-(79/13)), Jan. 22, 1979, *available at* http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6026-(79/13) (last visited on Apr. 17, 2014)

73 *Supra* note 71, at 105.

74 For details of the Swedish and Korean cases, *see id.* at 106-119.

75 *Supra* note 50, ¶ 20(a).

76 *Id*. ¶ 20(b).

77 The US Department of the Treasury, Report to Congress on Implementation of the International Monetary Fund's 2007 Decision on Bilateral Surveillance over Members' Policies, Aug., 2008, *available at* http://www.treasury.gov/press-center/press-releases/Documents/82808report.pdf (last visited on Apr. 17, 2014).

4. Challenging Japan's Monetary Policies under the WTO

A. Article XV of the GATT

The interplay between exchange rates and trade is not a new issue to global finance and trade.[78] Unlike the gold standard system, though the central banks are under certain limitations of banking regulation, they are still sensitive to the international ramifications when determining their money supply.[79] Particularly after the financial crisis, countries would seek to manipulate their currencies to achieve their protective policy goals.[80] In practice, "it was often difficult to separate exchange rate policies from trade policies, since countries could always substitute between them to gain competitive advantage."[81] The related country's market share should be eroded on the occurrence of currency undervaluation. This result is more obvious between competitive countries producing substitutes.[82] When floating exchange rates are coupled with manipulative central banks, the consequence should be trade imbalance and frustrate the increase of international trade flows.[83]

Under the GATT/WTO system, the concern over the impact of exchange rate volatility on trade could be traced back to the International Trade Organization ("ITO") negotiations.[84] During the negotiations of the Havana Charter, the potential negative effects of exchange rate movements on the trading system had already been expressed and led to a vivid debate.[85] Beckington and Amon maintain that: "The protectionist policies, including competitive currency depreciation, pursued by the major economic players of the age, combined with high tariffs and other restrictive measures, contributed significantly to the intensity and duration of the Great Depression."[86] Three delegates suggested introducing "dumping by means of

[78] *Supra* note 28, at 1.

[79] R. Kreitner, *Money Matters: the Law, Economics, and Politics of Currency: the Jurisprudence of Global Money*, 11 Theoretical Inq. L. 177, 185 (2010).

[80] P. Cwik, *The New Neo-Mercantilism Currency Manipulation as a Form of Protectionism*, 31 Econ. Aff. 9 (2011).

[81] *Supra* note 71, at 92.

[82] *Supra* note 26, at 10.

[83] *Supra* note 80, at 11.

[84] *Supra* note 28, at 2.

[85] *See* Section E of the Annexure 10 to the Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (E/PC/T/33 - Annex 1), regarding "avoidance of new tariff or other restrictive measures" before engaging in tariff negotiations. It called on countries not to make changes in the form of tariffs or in tariffs themselves due to devaluation of their currencies in such a manner that they would "result in an increase of the protective incidence of the tariff." *See supra* note 27, at 2.

[86] J. Beckington & M. Amon, *Competitive Currency Depreciation: The Need for a More Effective International Legal*

depreciation of currency" in the anti-dumping rules.[87]

In the end, however, this proposal was not ultimately adopted as remediable measures or clearly worded in the GATT. Regarding the omission, Beckington and Amon implied that under a fixed parity exchange rate system, countries could not change their exchange rates recognized by the IMF, otherwise, the country should be considered to apply "multiple currency rates" and violate Articles VI and XVI of the GATT.[88] After the foundation of the WTO, however, it signed cooperation agreement with the IMF to meet the demand of closer cooperation between international institutions having interlinked function.[89]

So far, currency issues, such as the exchange rates manipulation caused by monetary policies, have been neither resolved via the GATT/WTO dispute settlement process, nor interpreted by the dispute settlement body.[90] As both China and Japan are the members of the WTO, China may choose the WTO dispute settlement process to judge the legality of Japan's practice. If China is to initiate a complaint against Japan, it would be most likely based on Article XV of the GATT and the SCM Agreement. Although neither provision has ever been enforced in a meaningful way, they at least bespeak an awareness of how exchange rate measures can undermine a liberal trading system.[91] However, no obvious evidence or interpretation would show that these two terms are equal to each other. In practice, the term 'exchange arrangements' in Article XV of the GATT 1994 may be similarly interpreted as "exchange rate policies" in Article IV, Section 3 of the IMF Agreement. Meanwhile, one could argue that the international framework was undergoing a potential change in the past seventy years, the term 'exchange arrangements' should be endowed with current significance.[92]

Regime, 10 J. Int'l. Bus. & L. 209 (2011).

87 See *Report of the Drafting Committee of the Preparatory Committee*, U.N. Doc. E/PC/T/34 (Mar. 5, 1947), at 13, *available at* http://www.wto.org/gatt_docs/English/SULPDF/92290038.pdf (last visited on Apr. 18, 2014).

88 *Supra* note 86, at 228.

89 WTO, WTO and IMF Sign Cooperation Agreement, Dec. 9, 1996, *available at* http://www.wto.org/english/news_e/pres96_e/pr062_e.htm (last visited on Apr. 17, 2014).

90 Under the WTO/GATT system, the Ministerial Conference and the General Council have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements, but it has never interpreted the agreements till now. On the other hand, DSB could clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. *See* Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, art. 9.2, *available at* http://www.wto.org/english/docs_e/legal_e/04-wto_e.htm . *See also* WTO, Understanding on Rules and Procedures Governing the Settlement of Disputes, art. 3.2, *available at* http://www.wto.org/english/docs_e/legal_e/28-dsu.pdf (all last visited on Apr. 17, 2014)

91 *Supra* note 61, at 1050.

92 J. Sanford, Currency Manipulation: The IMF and WTO, CRS Report for Congress, May 8, 2008, *available at* http://research.policyarchive.org/20107_Previous_Version_2008-05-08.pdf (last visited on Apr. 17, 2014).

Second, regarding the phrase, "the intent of GATT is frustrated," under *Ad* Article XV(4) which provides:

> the word 'frustrate' is intended to indicate, for example, 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. Thus, a contracting party which, as part of its exchange control operated in accordance with the [IMF Agreement], requires payment to be received for its exports in its own currency or in the currency of one or more members of the IMF will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import license...

If only from literal understanding, this phrase could not serve as an independent basis for a WTO claim against maintaining an undervalued exchange rate. However, the above interpretation of the term 'frustrate' arguably does not preclude other interpretations since, in the *Ad* Article XV(4), the specified meaning is preceded by the words 'for example.'[93] To a certain extent, fundamental misalignment of exchange rates is an "improper reassertion of sovereignty" that would be the obstacle to achieve the shared goal of the monetary and trading systems.[94]

Furthermore, the preamble of the GATT states: "being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the **substantial reduction of tariffs and other barriers to trade** and to the elimination of discriminatory treatment in international commerce."[95] Given that the intent of the GATT was to liberalize trade among member States, Japan's continued interventions for suppressing the value of yen would affect the exchange rate between yen and other currencies of Asia, and thereby influence the price of goods from both Japanese and Asia countries. In this process, the Japanese manufacturers are getting more competitive, while the profit of other Asian trading partners deteriorated. These trade barriers would certainly frustrate the intent of the GATT and seriously erodes its underpinnings. This might be a possible issue relating to the trade impact of currency manipulation to be instituted before the WTO dispute settlement mechanism. Though this issue will cause many conceptual difficulties and possibilities, now is still too early to draw the conclusion. China or other countries influenced by Japan's policies shall request

93 Dukgeun Ahn, *Is the Contemporary Chinese Exchange-Rate Regime "WTO-Legal"?* Apr. 12, 2010, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1605542 (last visited on Apr. 17, 2014).

94 *Supra* note 86, at 246.

95 GATT pmbl. [Emphasis added]

consultations with Japan regarding this issue.

B. SCM Agreement

There are three possibilities for a WTO Member to correct the adverse impact caused by exchange rate misalignments under the existing disciplines of trade remedies. They are: (1) safeguards; (2) antidumping duties; or (3) countervailing duties.[96] As to antidumping duties, there has not been an antidumping investigation against all products from a single country. Similarly, safeguard measures are structured against the import of a specific product or line of products in an industry. The countervailing duties therefore seem to be the most likely of these three options, because the SCM Agreement was enacted to deal with the government interventions that possibly distort international trade.[97] The underlying logic is that undervalued currencies resulting from easing monetary policies led to a lower price of production, in effect subsidizing Japan's exports.

The term 'subsidy' has a precise definition in the WTO. Article 1 of the SCM Agreement provides that a necessary condition for the existence of a subsidy is "a financial contribution by a government or any public body," or else some form of "income or price support" that confers a 'benefit.' In addition, under Article 2 of the SCM Agreement, the subsidy must also be 'specific.'

1. Financial Contribution

Article 1.1(a) of the SCM Agreement provides a list of forms of financial contributions such as direct transfer of funds, foregone government revenue, the provision or purchase of goods or services other than general infrastructure, payments to funding mechanisms, etc. In *US-Export Restraints*, the Panel stated:

> The negotiating history confirms that items (i)–(iii) of that list limit these kinds of measures to the transfer of economic resources from a government to a private entity. Under subparagraphs (i)–(iii), the government acting on its own behalf is effecting that transfer by directly providing something of value - either money, goods, or services - to a private entity. Subparagraph (iv) ensures that the same kinds of government transfers of economic resources, when undertaken through explicit delegation of those functions to a private entity, do not thereby escape disciplines.[98]

96 Pereira & Allard, *supra* note 2, at 543.

97 WTO, World Trade Report 2006-Exploring the Links between Subsidies, Trade and the WTO, July 24, 2006, at 55, *available at* http://www.wto.org/english/res_e/booksp_e/anrep_e/wtr06-2c_e.pdf (last visited on Apr. 17, 2014).

98 Panel Report, *United States - Measures Treating Exports Restraints as Subsidies* (*US-Export Restraints*) ¶¶ 8.65

Although exchange rates undervaluation by monetary policies is not included, as a non-exhaustive list, it does not exclude currency depreciation.

2. *Benefit*

The benefit element is based on the recipient. In *Canada-Aircraft*, *e.g.*, the Panel found that: "It is necessary to determine whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution."[99] This opinion was upheld by the Appellate Body.[100] As the Japanese exporters have a cost advantage over China's producers due to Japan's monetary policies, the resulting cost advantage constitutes a benefit defined by Article 1.1(b) of the SCM Agreement.

3. *Specific*

All individuals and entities exchanging RMB for JPN receive the better rate of return. In this sense, Japan's policy is not forged to a particular industry or enterprise. Instead, a subsidy's non-export contingent character does not certainly affect its possible export contingency in relation to other set of circumstances. In *US-FSC* (*Article 21.5-EC*), the Appellate Body explained:

> The ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced within the US and held for use outside the US; and (b) where property is produced outside the US and held for use outside the US. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. … The subsidy granted with respect to the property produced within the US, and exported from there, is export contingent within the meaning of Article 3.1(a) of the SCM Agreement, irrespective of whether the subsidy given in respect of property produced outside the U.S. is also export contingent.'[101]

& 8.73, WT/DS194/R (June 29, 2001), *available at* http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#article1B2 (last visited on Apr. 17, 2014).

99 Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* (*Canada-Aircraft*) ¶ 9.112, WT/DS70/R (Apr. 14, 1999).

100 Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft (Canada-Aircraft)* ¶ 154, WT/DS70/AB/R (Aug. 2, 1999), *available at* http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#article1B3 (last visited on Apr. 17, 2014).

101 Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"(Article 21.5-EC)* ¶ 120, WT/DS108/AB/RW (Jan. 13, 2002).

5. Conclusion

Under the flexible exchange rate system, it is difficult to insulate monetary regime from politics.[102] Japan should advocate itself that the devaluation was a necessary tool. However, Japan's motives are easy to discern. With the easing policies, Japan would maximize their financial interest and simultaneously harms the benefit of other countries. If other factors remain equal, Japan's exports would become cheaper in the world markets, while imports become more expensive in its domestic market. Unless its policies are restrained and forbidden by the international community, other countries would follow it and bring worldwide volatility to the exchange rates. What Japan's macroeconomic action does suggest, however, is that advanced country central banks are likely to intervene in the currency markets by unconventional means, and set the stage for another round of protectionism.[103] Japan's distortion of exchange rate requires the cooperation between the IMF and the WTO to seek a satisfactory solution. The IMF prohibits countries from manipulating their currencies and exercises 'firm surveillance.' Without the tools for direct intervention, it cannot force a country to change its policies.

On the other hand, countries may inject cashes into currency market to affect exchange rate movements and thus boost their exports, these measures may effectively amount to "cheating on trade commitments."[104] If the issue of Japan's monetary policies enters the WTO dispute settlement process of and is verified to violate the rules, it can be enforced through the WTO enforcement mechanism. Given that Korea, Brazil and other countries are also complaining about the negative effects of the undervaluation of yen, China would firstly form a broad coalition of parties concerned and then adopt a diplomatic approach to urge Japan to adjust its policy. Failing such a coalition, China should take individual action under the IMF or WTO system.

102 *Supra* note 79, at 205-206.

103 M. Mohi-Uddin, *Towards a New Era of Currency Intervention*, FINANCIAL TIMES, Sept. 22, 2010, *available at* http://www.ft.com/intl/cms/s/0/00d3c340-c635-11df-9cda-00144feab49a.html#axzz2z8NUaWWC (last visited on Apr. 17, 2014).

104 R. COOPER, THE INTERNATIONAL MONETARY SYSTEM: ESSAYS IN WORLD ECONOMICS 142 (1987).