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The US Congress and the Chinese Yuan

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Introduction

In September 2003, Senator Schumer (D-NY) introduced the first Congressional bill (S. 1586) targeting the value of the yuan (then 8.28 to the dollar). Schumer's blunt remedy would have authorized a 27.5 percent US duty on all merchandise imports from China, if negotiations did not succeed in revaluing the yuan. The 27.5 percent figure represented Schumer's arithmetic average of two private estimates (40 percent and 15 percent undervaluation).

Since September 2003, Senators and Representatives, both Republicans and Democrats, have largely come to agree that "something ought to be done" about China's currency. Some three dozen new Congressional bills with various sponsors have been floated to challenge Chinese commercial practices, and the bills introduced since January 2005 increasingly focus on the currency value.¹ Figures 1 through 3 portray the real effective

¹ For a listing of bills through the middle of 2006, see Gary Clyde Hufbauer, Yee Wong and Ketki Sheth, *US-China Trade Disputes: Rising Tide, Rising Stakes*, Policy Analyses

exchange rate, the reserve accumulation figures, and the bilateral trade statistics that fuel Congressional discontent with China. Within Congress, there is little difference of opinion about the objective – a sharp appreciation of the yuan.² Congressional differences center on which levers should be applied to move Beijing, which legislators should claim patrimony for the law that emerges, and which Congressional committees should exercise oversight over subsequent developments.

While none of the proposed legislation has yet reached the desk of President Bush, the White House has certainly taken notice. Treasury Secretaries John Snow and Henry Paulson have valiantly tried to persuade Beijing that exchange rate flexibility is in China's own interest, as well as the interest of the United States and the world economy. In response, the Chinese authorities introduced a very constrained float in July 2005, and slightly widened the permitted daily fluctuation in May 2007. The net result of China's moves is that the yuan is now 7.49 to the dollar, an appreciation of 9.4% since September 2003. However, because the dollar has declined against most other currencies, in trade-weighted terms the yuan has only appreciated 6.2% since September 2003. By whatever metric the change in the yuan is calculated, the extent of appreciation falls far short of Congressional aspirations.

in *International Economics* 78, Washington DC: Institute for International Economics, August 2006.

² The leading candidates for the Democratic presidential nomination are all in accord.

The predictable result was a fresh crop of Congressional proposals in 2007,³ of which three are prominent: the Senate Finance Committee bill, sponsored by Baucus (D-MT), Grassley (R-IA), Schumer (D-NY), Graham (R-SC) and others (S. 1607), the Senate Banking Committee bill, sponsored by Dodd (D-CT) and Shelby (R-AL) (S. 1677), and the House bill (H. 2942) sponsored by Ryan (D-OH) and Hunter (R-CA).

If jurisdictional disputes can be settled – a big “if” – some amalgam of these bills may be approved by the House and Senate before the 110th Congress adjourns its first session in December 2007. The Treasury report on currency, which by law should have been presented to Congress on October 15, 2007, was delayed – possibly until after the December 2007 US-China Strategic Economic Dialogue (SED). The new IMF Managing Director, Dominique Strauss-Kahn, who took office on November 1, 2007, will inevitably be drawn into the currency debate. Congress may well take advantage of the shift in leadership at the Fund and the December SED meetings to assert its own views. The House is likely to move first since the Senate is locked in a jurisdictional struggle between the Banking and Finance committees. Congressional sponsors will attempt to draft legislation that is veto-proof, enacted by two-thirds majorities in both the House and Senate.

The details of the three referenced bills are summarized in Table 1. Essentially the bills have five moving parts: (1) while they differ in covering a wider or narrower range of

³ For a comprehensive list of all China related legislation introduced in the first session of the 110th congress as of September 28, 2007, see the US-China Business Council compilation available at <http://www.uschina.org/public/documents/2007/110th-congress-legislation-related-to-china.pdf>

currency practices, all the bills eliminate “intent” in determining whether or not a currency is “manipulated” or “misaligned”;⁴ (2) they instruct the Commerce and Treasury Departments to invoke unilateral and multilateral trade remedies if China does not revalue; (3) they instruct the Treasury to present a more forceful case in the IMF; (4) they enunciate various deadlines for action, ranging up to 360 days; and (5) some of the bills allow a presidential waiver. For purposes of this short review, we discuss four important questions.

- Will the process of Congressional enactment and subsequent implementation serve as a helpful lever in persuading Beijing to revalue the yuan?
- What will come from engaging the WTO in exchange rate questions, either directly through a GATT Article XV(4) “frustration” case or through an ASCM “prohibited subsidy” case, or indirectly through US countervailing duty and anti-dumping duty cases?
- What are the consequences of legislation that gives Congress a larger oversight role over exchange rate questions, at the expense of the Treasury and the Federal Reserve?
- What are the chances of mirror legislation abroad that might, in the future, target the dollar as an undervalued currency?

Legislation as a Lever?

⁴ In its June 2007 semi-annual currency report, the Treasury suddenly added an “intent” test to determine whether a currency is “manipulated”, and found that no intent could be ascribed to China (these reports are mandated by legislation enacted in 1988). Prior to 2007, the Treasury drew upon a shifting basket of touchstones to determine “manipulation”, however the “intent” concept only appeared in 2007. See Henning (2007).

By contrast with earlier drafts, the current bills deliberately stretch out the period for China to revalue before consequences are felt. Since WTO litigation and IMF deliberations could easily take a year or more, the bills contemplate an action horizon of two to four years. Moreover, the Senate bills allow the president to invoke a national interest waiver (subject to Congressional override in the Finance bill), thereby holding out the possibility for China to escape any penalties. In short, the bills are akin to turning the screw rather than slamming the hammer. Congress, however, will keep a watchful eye while the screw is turned: designated Congressional committees (chiefly the Senate and House finance and banking committees) will closely monitor the Administration's actions, the value of the yuan, and the path of China's bilateral and multilateral trade balances.

On July 31, 2007, Treasury Secretary Henry Paulson, joined by Commerce Secretary Carlos Gutierrez and Trade Ambassador Susan Schwab, speaking in Beijing, declared that new legislation would jeopardize their efforts to persuade China to move quickly towards a market-determined exchange rate.⁵ Moreover, Congressional bills have attracted sharp criticism from prominent economists (including Nobel Laureates) and respected columnists (such as Nicholas Kristof of the *New York Times*).⁶ But Administration opposition and ill-considered comparisons to the Smoot-Hawley tariff are not likely to derail the Congressional locomotive.

⁵ Mark Drajem, "Paulson Calls China Currency Legislation the 'Wrong Approach' ", *Bloomberg*, July 31, 2007.

⁶ Pat Toomey, "Economists Against Protectionism", *The Wall Street Journal*, August 1, 2007; Nicholas Kristof, "The New Democratic Scapegoat", *New York Times*, July 26, 2007, p.A.18.

A crucial question in the fall of 2007 is whether the prospect of legislation will persuade Beijing either to accelerate its appreciation of the yuan or to allow more flexibility. As a stand-alone measure, a new US law might have little effect. Powerful forces within China stoutly oppose revaluation – particularly export industries that operate on thin profit margins and discount the offsetting effect that appreciation would exert on the prices they must pay for imported inputs. People’s Bank of China Deputy Governor Wu Xiaoling explained that an appreciation of the yuan would not decrease the dependence of the Chinese economy on exports, and that internal restructuring is indispensable to boost consumption and move smoothly towards more flexibility.⁷

But prospective US legislation is not a stand-alone measure. Any new law looks like being enacted at a time when multilateral forces are gathering to confront China. Erstwhile IMF Managing Director, Rodrigo de Rato, set in motion a review of the 1977 guidelines to Fund Article IV that was concluded in June 2007. The review proposed a more assertive IMF posture towards the yuan. New Managing Director Dominique Strauss-Kahn will likely amplify de Rato’s initiative. President Nicolas Sarkozy of France has added a fresh European voice to calls for revaluation.⁸ Other European leaders, noting the rapid appreciation of the euro against the dollar and the possibility that the euro will top \$1.50, will likely become more eager for Asian currencies to absorb part of the global adjustment burden. The next US president seems certain to embrace the thrust of Congressional complaints, especially since both Republicans and Democrats are

⁷ “A Warning on Chinese Currency”, *Washington Trade Daily*, October 22, 2007.

⁸ *Financial Times*, July 23, 2007, p. 2.

prominent sponsors of new legislation. Finally, the textile, clothing and steel industries can be counted on to push the currency bills.⁹

Taking a leaf from scholarship on economic sanctions to achieve political goals, the evidence suggests that multilateral pressure is somewhat more likely to change the target country's policies in a desired direction than unilateral pressure.¹⁰ Faced with a growing coalition, it seems possible that China will accelerate the path of yuan flexibility and appreciation – in hopes of softening the final bill and preventing the nascent US-EU alliance crystallizing into a solid front.

Engaging the WTO?

A theme among several bills is to engage the WTO in the currency dispute, directly or indirectly. The direct approach has two prongs: a US case brought to the WTO under GATT Article XV(4), alleging that China's undervalued yuan "frustrates the intent of the provisions of [the GATT]", and a US case brought to the WTO under Article 3 of the Agreement on Subsidies and Countervailing Measures (ASCM), alleging that the undervalued yuan amounts to a "prohibited [export] subsidy".

The indirect approach would characterize the undervalued yuan as a subsidy for purposes of the US countervailing duty (CVD) law or would use the "corrected" value of the yuan

⁹ See, for example, Stephen Cooney, *Steel: Price and Policy Issues*, *CRS Report for Congress RL32333*, Congressional Research Service, August 30, 2007.

¹⁰ Gary Clyde Hufbauer, Jeffrey J. Schott, Kimberly Ann Elliott and Barbara Oegg, *Economic Sanctions Reconsidered*, 3rd edition, Washington DC: Peterson Institute for International Economics, forthcoming 2007.

to calculate the margin in an anti-dumping (AD) case. Under the CVD and AD remedies, an affected US industry could bring a case to the US Department of Commerce (on the subsidy determination) and the International Trade Commission (on the injury determination); an affirmative finding by both agencies would lead to the imposition of a CVD or AD duty on imported Chinese merchandise, calculated to reflect the extent of yuan undervaluation. Thereafter, China could mount challenges both in the US courts and the WTO.

Elsewhere, my colleagues and I have written that the United States would face an uphill battle, in legal terms, in bringing a GATT Article XV(4) case.¹¹ Certainly an argument can be made that prolonged undervaluation of a major currency threatens the world trading system. But a GATT Article XV(4) case faces a fundamental obstacle: when the Bretton Woods institutions were founded, exchange rate issues were assigned to the IMF and trade questions were assigned to the GATT. While each institution intrudes to some degree into the business of the other, the intrusions are at the margins, not the core. If the WTO were to declare that China's exchange rate practices violate the GATT, without a prior but contemporaneous determination by the Fund that the value of the yuan is threatening the world trading system, a considerable part of the Fund's mandate would migrate from Washington to Geneva. That prospect would prompt a collective gasp of horror in finance ministries and central banks worldwide.

¹¹ See Hufbauer *et alia*, *op. cit.*, pp. 17-20.

To be sure, in October 2006 the Fund declared in its staff report concerning Article IV consultations with China that the yuan is undervalued.¹² But this was a staff report, not a direct pronouncement of the Managing Director or the Executive Board. Moreover the Fund staff did not allege that the currency is “manipulated” – the legal term for an offensive practice under Article IV. Nor did the Fund staff use language that would put China in the dock for upsetting world trade. If senior Fund officials are prepared to criticize China in plain language, mere anticipation of such criticism, combined with pressure from the European Union and the United States, would likely foster a new exchange rate regime by Beijing. If China did not move, the lead members of the Fund might collectively devise a financial solution that would prompt good behavior without resorting to trade measures authorized by the WTO. Only as a last resort, in our opinion, would the Fund give a green light to the WTO to authorize trade sanctions.

¹² The report states that “...since the previous peak in the renminbi’s real effective value in early 2002, the currency has depreciated, while such factors as a substantial net foreign asset accumulation and a sharp rise in China’s productivity relative to partner countries over the period since 2001 would be expected to have contributed to a real appreciation of the currency. (...) It is especially difficult to pinpoint a change in fundamental determinants [of savings behavior] that would explain the doubling of the [current account] surplus in relation to GDP in 2005 and that would suggest that the surplus at its present level could be considered to be a new “normal” level of the savings-investment balance for China. In addition, gross official reserves have risen from \$219 billion in 2001 to \$930 billion at end-May 2006. (...) All of these developments point to the currency as being undervalued and that this undervaluation has increased further since last year’s Article IV consultation.” (*IMF Country Report* No. 06/394). In October 2007, G7 countries released the following statement: “We welcome China’s decision to increase the flexibility of its currency, but in view of its rising current account surplus and domestic inflation, we stress its need to allow an accelerated appreciation of its effective exchange rate.” (“Text of G7 Communiqué”, *MarketWatch*, October 19, 2007). Again, this language from the G7 (not the IMF) does not amount to an explicit condemnation of China for bad behavior.

Other weaknesses of the hypothetical GATT Article XV(4) case, of a more technical nature, can be pointed out.¹³ In any event, debating the pros and cons of a case could easily occupy the WTO's Dispute Settlement Mechanism for two years or longer. We are left with the conclusion that an Article XV(4) case can best be justified as a lever to prompt more forceful action by the IMF (if only to preserve the Fund's turf), and as one means of focusing Beijing's attention on the currency question.

Congressional legislation also contemplates a US case in the WTO characterizing the undervalued yuan as a "prohibited [export] subsidy", citing Article 3 of the Agreement on Subsidies and Countervailing Measures (ASCM, one of the Uruguay Round agreements). For the United States, this case would entail another uphill legal battle. First, to be characterized as a subsidy under the ASCM, a public measure must entail a "financial contribution" from the government (ASCM Article 1.1). An argument can be made that an undervalued exchange rate extends a financial contribution to exporters, and imposes a financial penalty on importers. But public budgets have seldom if ever characterized changes in the exchange rate as a form of public revenue or expenditure. If trade negotiators had meant to ignore budget conventions and characterize an undervalued exchange rate as a subsidy, they would have said so – in the ASCM or predecessor agreements, stretching back to the 1960s.

¹³ These are explored in Hufbauer, *et alia, ibid.* Besides these technical difficulties, it should be remembered that every "undervalued" currency implies that some other currency is "overvalued". China might respond to a US Article XV(4) case against the yuan with its own Article XV(4) case against the dollar.

Second, to be actionable either under the WTO or under national CVD laws, a subsidy must be “specific” as defined in ASCM Article 2. The basic idea is that the public financial contribution should confer a benefit on a enterprise or industry, or group of enterprises and industries. Changes in exchange rates and interest rates would seem to be the opposite of “specific” policies. They rank among the broadest measures that a government can employ to influence the economy.

Considering just the tests of “financial contribution” and “specificity”,¹⁴ a strong policy argument can be made that the ASCM never intended to intrude on the Fund’s mandate as the arbiter of exchange rates. However, as with a WTO case under GATT Article XV(4), a WTO case under ASCM Article 3 might focus Beijing’s attention on the tensions fostered by an undervalued yuan, even if the case does not rest on the strongest legal foundation.

Congressional legislation might also authorize penalty duties against an undervalued yuan in the context of US CVD and AD determinations. By comparison with a WTO case, national CVD and AD cases would alter the sequence between legal argument and commercial penalty. In the WTO, even in a winning case, legal arguments can easily take three years before a countermeasure is authorized against the respondent country. In a national CVD or AD case, however, after six months of legal argument, penalty duties are often applied. In practical terms, the burden is on the exporter to disprove the allegation of unfair trade practices. The exporting country (China) can contest penalty

¹⁴ Other tests, of a more technical nature, need to be met for a practice to be designated as a “prohibited [export] subsidy”. See Hufbauer, *et alia*, pp. 20-24.

duties in national (US) courts. If China prevails, the duties collected will be refunded; in the meantime, however, US imports of the affected merchandise will certainly be reduced, perhaps sharply.

China can also challenge the CVD or AD determination in the WTO. With respect to a CVD determination, China can cite the ASCM tests of “financial contribution” and “specificity”. With respect to an AD determination, China can argue the absence of authority in the GATT Agreement on the Implementation of Article IV (ADP) for calculating the dumping margin using a “corrected” exchange rate; China can also argue the absence of precedent in prior anti-dumping cases. To us, it appears that China’s legal arguments against AD penalty are weaker than its arguments against the other trade penalties we have reviewed. Still, China might eventually prevail, but WTO relief is not retroactive: penalty duties collected in the meantime (perhaps two or three years) will never be refunded.

We are left with the conclusion that trade remedy measures, sought in the WTO or under US laws, can best be justified as levers to prompt more forceful action by the IMF and as a means of focusing Beijing’s attention on the currency question.

Giving a Larger Voice to Congress?

Apart from whatever influence Congressional legislation might exert on the Chinese yuan in the contemporary debate, another consequence is that Congress – more specifically the

Senate and House finance and banking committees – would establish a claim for more and larger chairs at the exchange rate table. This claim is reinforced, in the Ryan-Hunter and Senate Finance Committee bills, by establishing a new Advisory Committee on International Exchange Rate Policy, with several members designated by the Senate and/or House. The Congressional assertion of a larger role in exchange rate matters can be seen as part of the enduring contest between the President and the Congress over their respective powers in the arena of foreign affairs. President Bush is clearly on the defensive in terms of war powers and trade agreements, and currency relations could be added to the list.

The different Congressional bills also reflect a power struggle within the Senate as to which committee should have jurisdiction over the currency issue. The discord is reflected in definitions of offensive undervaluation that should elicit action – specifically the distinction between “manipulated” and “misaligned” currencies. “Manipulation”, with its emphasis on one-way central bank intervention and its antecedents in IMF Article IV, would more clearly confer jurisdiction on the Senate Banking Committee.

On the other hand, “misalignment”, with its emphasis on trade consequences, would confer at least some oversight authority on the Senate Finance Committee.

“Misalignment” is a broader concept, since it encompasses undervaluation resulting from market forces as well as central bank intervention – and thus potentially sweeps in the

Japanese yen and other Asian currencies as well as the Chinese yuan.¹⁵ The auto industry and Michigan congressmen are strong supporters of the “misaligned” currency concept because of the role that Japanese auto firms play in the US market.¹⁶

The clear losers from giving Congressional committees more and larger chairs at the exchange rate table would be the Treasury and the Federal Reserve, which for decades have enjoyed almost exclusive authority over exchange rate questions, usually exercised behind closed doors.¹⁷ Coming to legislative specifics, the Senate Banking Committee bill would guide the Treasury’s hand in dealing with the IMF, and would constrain the Treasury’s latitude in composing its semi-annual exchange rate report to Congress. The Senate Finance Committee bill would give the US Trade Representative a role in bringing cases to the WTO, and the Commerce Department a second-string role (after the Treasury) in determining the extent of undervaluation in CVD and AD cases. Both

¹⁵ The yen at around Y114 to the dollar (October 26, 2007) is arguably “misaligned”, since Japan continues to run huge current account surpluses. However, since the Japanese authorities have not intervened in the exchange market for the past three years, it is hard to say the yen is “manipulated”; yen undervaluation largely reflects the eagerness of Japanese households and firms to earn higher returns by placing their capital abroad.

¹⁶ In an interesting twist, while the Senate Finance bill headlines the term “misalignment”, when defining “priority action” countries the bill reverts to the concept of “manipulation”, namely countries that are “engaging in protracted large-scale intervention in one direction in the currency market”. Perhaps the drafters understand that other countries could say that the dollar is “misaligned”, since the value is far from a rate that would be consistent with a current account deficit under 3 percent of GDP. By creating a “priority action” category, they may hope to avoid scrutiny of the dollar, if other countries enact mirror legislation.

¹⁷ The semi-annual Treasury currency reports, mandated in 1988, represent the first significant Congressional intrusion into the secretive realm of Treasury and Federal Reserve deliberations. See Henning (2007).

provisions would erode the Treasury's primacy within the Administration, and would confer oversight responsibilities to the Congressional finance and banking committees.¹⁸

Those with long memories will hear an echo from earlier episodes, when Congress shifted responsibility for trade negotiations from the State Department to the US Trade Representative (in 1963), and responsibility for administering the US countervailing duty and anti-dumping laws from the Treasury Department to the Commerce Department (in 1979). The earlier events reflected Congressional dissatisfaction with the commercial vigor of the State Department as a negotiator and the Treasury Department as an enforcer. At the same time, both changes enlarged Congressional oversight.

From the perspective of a smoothly functioning international system, more and larger Congressional chairs at the exchange rate table will raise questions. The "beauty" of the post-Smithsonian system is that a small number of finance ministers and central bankers, sometimes joined by senior Fund officials, can quickly respond to exchange rate crises. If the enlarged Congressional voice is only heard in exceptional circumstances, and does not impede crisis management, it would be hard to criticize the new arrangement.

On the other hand, if Congressional committees use their seats at the exchange rate table to pressure foreign countries over collateral grievances – bilateral trade balances, investment regimes, labor rights, carbon emissions, etc. – that could severely disrupt the

¹⁸ C. Randall Henning, Congress, Treasury, and the Accountability of Exchange Rate Policy: How the 1988 Trade Act Should be Reformed, *Peterson Institute for International Economics Working Paper series WP 07-8*, September 2007.

international system. On present evidence, there is no indication of such tendencies. Moreover, if four Congressional committees – Senate Finance, House Ways and Means, Senate Banking, House Banking – collectively “share” the Congressional seat, it seems less likely that collateral grievances will intrude on the deliberations.

Mirror Legislation Abroad?

When Congress enacts legislation affecting foreign commerce, it often overlooks the likelihood that its handiwork will be mirrored abroad, in ways not favorable to US economic interests. Treasury Secretary Henry Paulson has warned against a global cycle of protectionist legislation at a time of growing US exports. The most memorable and regrettable experience was the Smoot-Hawley Tariff Act of 1930. Other ricochet examples can also be cited: countervailing duty and anti-dumping penalties; Buy America provisions; cabotage limits on maritime and air traffic; and agricultural import quotas to reinforce domestic farm subsidies. If Congress enacts legislation that guides the Administration’s hand, ultimately leading to penalty trade measures, it seems likely that the European Union, China and perhaps Japan will fashion their own exchange rate laws that might, at some future date, target trade remedies against an undervalued dollar. After all, if the United States eventually balances its prolonged run of current account deficits (and capital account surpluses) with a prolonged run of opposite sign, important trading partners will likely consider the US dollar undervalued.

How should the possibility of mirror legislation be factored into the Congressional debate? One recommendation, not likely to gain traction on Capitol Hill, is simply to set aside trade measures that would penalize an undervalued exchange rate and instead concentrate new legislation entirely on IMF deliberations. A more plausible recommendation is to limit trade measures to situations where four tests are met: the country is a major commercial power; the foreign currency is “manipulated” through persistent one-way official intervention as determined by the Fund; the country is running large current account surpluses on a global basis; and the country’s official reserves substantially exceed an adequate level for prudential purposes.

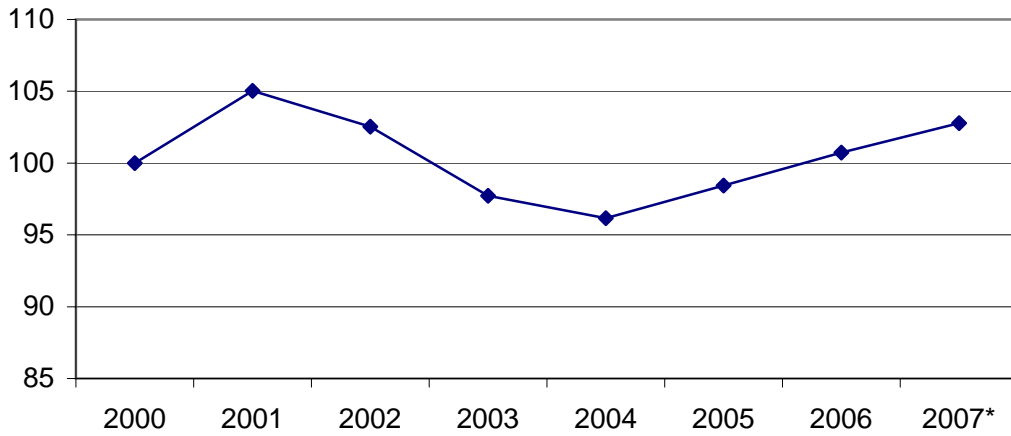
Table1. Three Leading Congressional Bills on China’s Currency

	Ryan-Hunter (<i>House</i>) <i>Currency Reform for Fair Trade Act of 2007</i> (H.R.2942)	Schumer-Grassley-Graham-Baucus (<i>Senate Finance</i>) <i>Currency Exchange Rate Oversight Reform Act of 2007</i> (S.1607)	Dodd-Shelby (<i>Senate Banking</i>) <i>Currency Reform and Financial Market Access Act of 2007</i> (S.1677)
Overview	<ul style="list-style-type: none"> ▪ Many countries intervene in currency markets leading to misaligned currencies: e.g. the RMB is undervalued by 40% or more. ▪ Undervaluation, regardless of intent, acts as an export subsidy and a non-tariff barrier against imports; a misaligned exchange rate should be defined as a countervailable subsidy, both for market and nonmarket economies. 	<ul style="list-style-type: none"> ▪ Replace the term “manipulation”, and its connotation of intent with “fundamentally misaligned”, which could result either from government policy or from market forces. ▪ Revise US anti-dumping law so that the export price is adjusted to account for undervaluation, thereby augmenting the penalty duty. 	<ul style="list-style-type: none"> ▪ “Manipulation” is an unfair trade practice and strategic dialogue with China has not worked. ▪ Currency manipulators need to be identified and addressed, with no regard to intent. ▪ US should promote market access for financial firms in China.
Procedures	<ul style="list-style-type: none"> ▪ Treasury should consult with the Federal Reserve and the newly-formed Advisory Committee on International Exchange Rate Policy, and submit a report to Congress twice a year identifying misaligned currencies and engage in bilateral negotiations with those countries. ▪ In the case of “fundamental and actionable misalignment” the Treasury should seek the support of the IMF and other countries; the US should oppose any change of rules at the IMF that would benefit a misaligned country; it should oppose multilateral bank financing and OPIC loans to companies in that country; and the US should take misalignment into account for NME status and anti-dumping cases. ▪ If there is no result in 360 days, the US should initiate a WTO dispute settlement case and consider remedial intervention. 	<ul style="list-style-type: none"> ▪ Treasury should consult with the Federal Reserve and the new Advisory Committee on International Exchange Rate Policy to identify “fundamentally misaligned” currencies twice a year and consult with those governments. ▪ If misalignment is driven by explicit government policy, then Treasury must designate that currency for “priority action”, consult with that country; seek advice and support from the IMF and other countries; and oppose any IMF rule change that would benefit that country. ▪ If there is no result in 180 days, the US should stop all federal purchases of that country’s goods and services; reflect the undervalued exchange rate in anti-dumping duties; request the IMF to consult with the misaligned country; oppose multilateral bank financing and OPIC loans to US companies operating in that country. ▪ If there is no result in 360 days, the US should initiate a WTO dispute settlement case and consider remedial intervention. 	<ul style="list-style-type: none"> ▪ Treasury should submit a plan of action to Congress within 30 days of finding manipulation and engage in bilateral and multilateral negotiations. ▪ Treasury must seek IMF consultation with the country and use its IMF voting power against this country if necessary. ▪ If there is no result after 9 months, the Treasury has the authority to file a WTO Article XV(4) case. ▪ Congress can originate a joint resolution of disapproval when Treasury does not cite manipulation.

Table1. (Continued)

	Ryan-Hunter (House) <i>Fair Currency Act of 2007</i> (H.R.2942)	Schumer-Grassley-Graham-Baucus (Senate Finance) <i>Currency Exchange Rate Oversight Reform Act of 2007 (S.1607)</i>	Dodd-Shelby (Senate Banking) <i>Currency Reform and Financial Market Access Act of 2007 (S.1677)</i>
Waiver	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ Presidential waiver if the actions in the bill can have damaging consequences for vital economic or security interests. ▪ Congress can override the waiver through a joint resolution of the House and Senate. 	<ul style="list-style-type: none"> ▪ Presidential waiver if the actions in the bill can have damaging consequences for vital economic or security interests.
Definitions	<ul style="list-style-type: none"> ▪ Fundamental and actionable misalignment: “the situation in which an exporting country’s prevailing real effective exchange rate is undervalued relative to the exporting country’s equilibrium real effective exchange rate and the Secretary of Treasury determines that <ul style="list-style-type: none"> (i) the amount of the undervaluation exceeds 5% and has consistently exceeded 5% on average in the 18-month period preceding the date of the calculation; and (ii) the undervaluation is a result of protracted, large-scale intervention in the currency exchange markets; excessive reserve accumulation; restrictions on or incentives for, the inflow or outflow of capital, that is inconsistent with the goal of achieving currency convertibility; or any other policy or action by the country that issues the currency.” 	<ul style="list-style-type: none"> ▪ Fundamentally misaligned: “significant and sustained undervaluation of the prevailing real effective exchange rate , adjusted for cyclical and transitory factors, from its medium-term equilibrium level”. ▪ Fundamentally misaligned currency for priority action: “if the country that issues the policy is engaging in protracted large-scale intervention in one direction in the currency exchange market, accompanied by partial or full sterilization; engaging in prolonged official or quasi-official accumulation of foreign assets for balance of payments purposes; introducing or substantially modifying, for balance of payment purposes a restriction on, or incentive for, the inflow or outflow of capital, that is inconsistent with the goal of achieving full currency convertibility; or pursuing any other policy or action that, in the view of the Secretary, warrants designation for priority action.” 	<ul style="list-style-type: none"> ▪ Manipulator: a country that has “a material global current account surplus and has significant bilateral trade surpluses with the US and has engaged in prolonged one-way intervention in the currency markets.”
Special committees	<ul style="list-style-type: none"> ▪ Creation of an Advisory Committee on International Exchange Rate Policy – consisting of 7 members (3 Senate appointees, 3 House appointees and 1 presidential appointee) – to advise the Secretary of Treasury, Congress and President on international exchange rate matters. The committee can submit a report disagreeing with the Treasury. 	<ul style="list-style-type: none"> ▪ Creation of an Advisory Committee on International Exchange Rate Policy – consisting of 9 members (8 Senate Finance and Banking committees appointees and one presidential appointee) – to advise the Secretary of Treasury, Congress and President on international exchange rate matters. 	
WTO compliance	<ul style="list-style-type: none"> ▪ GATT Article XV(4) would take WTO into IMF turf; exchange rate needs to “frustrate” another GATT article for Article XV(4) to apply; the WTO would probably look to the IMF to declare “manipulation”. ▪ For ASCM: Need to prove financial contribution from the government to a specific enterprise or industry (as well as other tests). 		

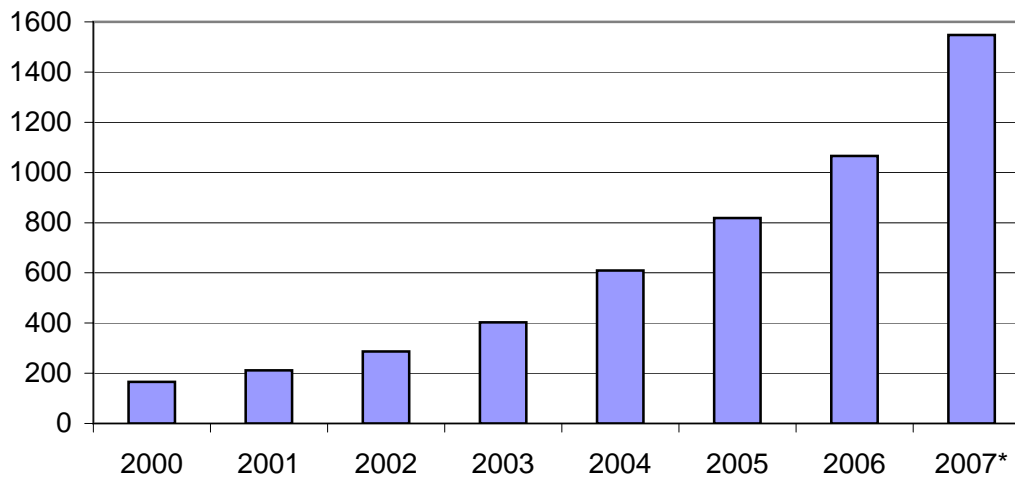
Figure 1. Real effective exchange rate for the RMB (higher number means RMB appreciation)



Source: Source: JP Morgan

* Estimated based on data from the first half of 2007

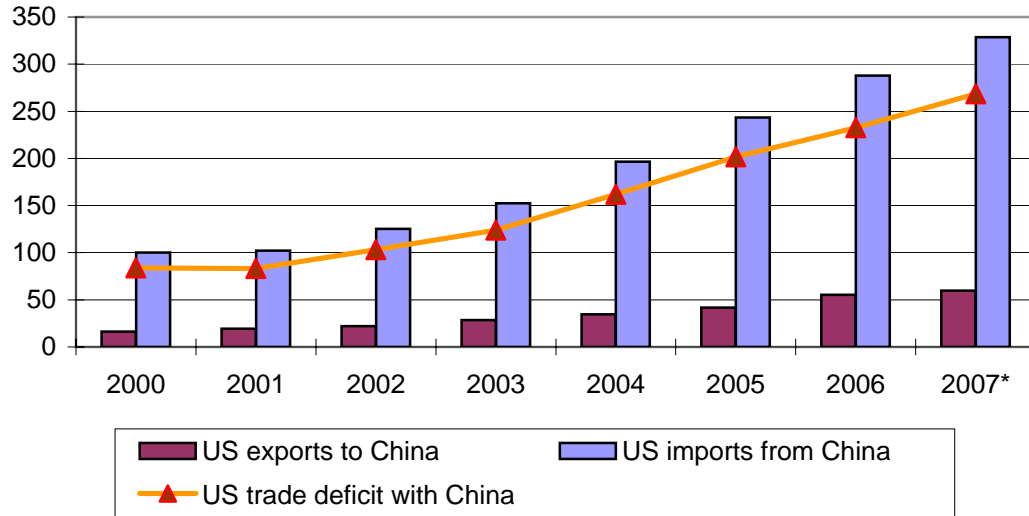
Figure 2. China's foreign exchange reserves, in billions of dollars



Source: People's Bank of China Online Statistics

* Estimates based on data from the first half of 2007

Figure 3. US-China bilateral merchandise trade, in billions of dollars



Source: US Census Bureau

Note that US bilateral trade figures differ significantly from those published by China.

* Estimates based on data from the first half of 2007