ELSA MOOT COURT COMPETITION (EMC2) 2012-2013

The Bench Memorandum

Fixitania – Certain Measures affecting Financial Services and Influencing the Exchange Rate

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I. Facts of the Case

Fixitania (F) is a developed WTO member and a member of the International Monetary Fund (IMF). Libertania (L) is also a developed WTO member and also a member of the IMF. Both countries are party to the Vienna Convention on the Law of Treaties.

F has made specific commitments under the GATS for financial services. Its Schedule of Specific Commitments states:

“Fixitania undertakes commitments on Financial Services in accordance with the provisions of the “Understanding on Commitments in Financial Services”.

With regard to restrictions on national treatment in the Financial Services sector, the Fixitanian Schedule states “None”.

Until the start of the global economic crisis of 2007, F was an extremely open, trade-oriented and liberal economy. In particular, the financial sector of F was globally active in doing business, based on F’s legislation for the banking sector and financial services, which provided, among other things, for free movement of capital and payments with third countries, subject only to an emergency clause that allowed the Fixitanian government (FG) to introduce restrictions on the free movement of capital and payments in case the foreign currency reserves managed by the Fixitanian Central Bank (FCB) fell below the equivalent of 1.5 Billion Special Drawing Rights (SDRs). The exchange rate of the Fixitanian currency, the “Fixi”, was freely floating and the FCB was not intervening on the exchange markets in order to influence the course of the “Fixi” against any other currency. The FCB is established by Fixitanian law, is owned by the FG and is under the direct authority by the Fixitanian Minister of Finance. The profit of the FCB that derives from its monetary policy and foreign reserve transactions is transferred to the FG on an annual basis.
Once the global financial and economic crisis hit, Fixitanian commercial banks faced serious trouble, as they had been borrowing short-term on the global financial markets (mainly in US-Dollar) and had lent long-term to foreign borrowers, also mainly in US-Dollar. As a consequence, the FG in 2007 had to introduce restrictions on the free movement of capital in order to prevent the total drying-up of its foreign currency reserves. Furthermore, in order to prevent a collapse of major Fixitanian banks, the FG passed the “Regulatory Emergency Ordinance for Financial Institutions (REOFI)”, according to which savings in F were guaranteed by the FG, but only for banks that were registered in Fixitania and had a majority of domestic shareholders. Banks that were subsidiaries of foreign banks, i.e. banks with 51% of foreign shareholders, were exempted from the guarantee. As a consequence, non-guaranteed banks lost many of their customers and business.

Due to the crisis, the gross domestic product (GDP) of F fell 15% within one year and unemployment climbed to a record high of 20%. In 2008, the majority of the Fixitanian population voted for a newly founded protest party in the general elections. After the elections, the new government declared that “the forces of global financial capitalism must never again endanger the Fixitanian people and prosperity”. The Fixitanian parliament enacted the “Fixitanian Stability, Economic Growth and Social Justice Act” (FSEGSJ). The FSEGSJ contains numerous provisions re-organizing the financial markets and supervision of financial institutions. It also abolishes the general freedom to export capital, but upholds freedom of payments with third countries, and encourages investments in the manufacturing sector.

Furthermore, the FSEGSJ introduces a dual-exchange rate regime with a fixed exchange rate for export transactions of Fixitanian exporters. Under that system, exporters can register with the FCB and be granted the status of an “Exporter of National Relevance” (ENR). ENRs are legally entitled and obliged to exchange their foreign-currency income at an exchange rate for the Fixi which is being fixed against the Libertado, the currency of Libertanian, Fs largest trading partner (a so-called “currency peg”); the applicable exchange rate is set by the FG, and the FCB is tasked with buying all foreign currencies offered by ENRs at the respective rate against Fixi. All other foreign exchange transactions take place on a foreign exchange market, the exchange rate being the result of supply and demand (the Free Currency Market (FCM)). The FCB does not intervene in this market at any time.

Due to a number of further economic and social reforms, the Fixitanian economy recovered quickly. Investments are no longer being made in the financial services industry but in high-technology industries, including the engineering and manufacturing of hybrid cars. Furthermore, F exports large quantities of biofuels. As a consequence of the growing exports, the prohibition to export capital and the obligation to buy unlimited amounts of foreign currency from ENRs, the FCB accumulated foreign currency reserves worth approximately 500 Billion SDRs between 2008 and 2011. The current account balance for 2011 showed an overall trade-surplus of 200 Billion SDRs with the rest of the world and a bilateral trade-surplus against Libertania of 100 Billion SDRs. Over the same period of time, the exchange
rate for the Fixi on the FCM increased significantly, whereas the fixed export exchange rate applicable to ENRs was held constant by the FG, at the end of 2011, the Fixi traded at a rate 25% higher than the fixed exchange rate applicable to ENRs.

In its Staff Report, following regular consultations under Article IV IMF in the spring of 2012, the Fund stated that F had regained its economic strength and should now move to a more flexible and uniform exchange rate regime in order to reduce the current trade-surplus and economic imbalances. The Fund also found that the ENR exchange rate for the Fixi set by the FG is “significantly undervalued”. The staff report, however, did not make an assessment whether the exchange rate regime of F was in breach of Fs obligations under the IMF Articles of Agreement.

In Libertania, the manufacturers of hybrid cars increasingly suffer from the competition of Fixitanian hybrid car producers, who sell their products 20% below the price of hybrid cars produced in Libertania. Economists in Libertania consider the fixed exchange rate of the Fixi against the Libertado to be at least 15% undervalued. According to the same economists, the Fixi should trade at a higher rate against the Libertado under market conditions.

Forced by strong lobbying efforts of the Libertanian hybrid car producers and banks, the Libertanian government adopted the position of the industry and requested consultations under the WTO dispute settlement understanding (DSU) with Fixitania. After two months the consultations ended without any substantial concessions by Fixitania. Libertania now requests the establishment of a Panel. The Panel was established at the next meeting of the WTO Dispute Settlement Body (DSB).

In its request for consultations, the Libertanian government argues that the Fixitanian REOFI and the exchange rate regime established by the FSEGSJ breaches several provisions of the WTO agreements. In particular, Libertania argues:

a. that the REOFI breaches Article XVII of the General Agreement on Trade in Services and paragraph 2 of its Annex on Financial Services, and

b. that the FSEGSJ breaches

i. the Agreement on Subsidies and Countervailing Measures in conjunction with Art. VI and XVI GATT, since the dual exchange rate regime constitutes a prohibited export subsidy;

ii. Art. XV:4 GATT in conjunction with the provisions of the IMF Articles of Agreement, in particular Art. IV (1) iii) thereof, since the exchange-regime constitutes a manipulation of the exchange rate of the Fixi that frustrates the intent of the GATT 1947;

The Chairman of the WTO DSB, pursuant to the WTO-IMF Cooperation Agreement, informed the IMF of the dispute. The IMF, following the applicable procedural provisions, replied to the Chairman of the DSB and referred in its letter to the Staff Report of the 2012 Article IV
consultations (see para. 8 above). The Chairman of the DSB informed the Chairman of the Panel of the letter and made it available to the Panel as well as the Fixitanian and Libertanian delegations. The Panel decided to consult experts in accordance with Art. 13.2 of the DSU. The uniform view of all consulted experts is that the fixed exchange rate is at least between 15 and 20% undervalued as compared to (hypothetical) market conditions.

II. Clarifications

During the course of the Competition, some 240 clarification requests were submitted and answered by the Case Author. Most importantly, it was pointed out in the answers to the requests that Claim b) by Libertania is not to be understood as also challenging the FSEGJS as an actionable subsidy. It was further clarified that the claims raised by Libertania in its request for consultations are identical to the claims raised in the request for a Panel. All requests for more precise economic data on market shares, exchange rate developments, balance-of-payments etc. remained unanswered as irrelevant. From the point of view of the Case Author, the legal matters raised by the Case could be sufficiently argued on the basis of the facts provided. Generally, the emphasis of the arguments made should be on the legal questions and not the related economic questions.

III. Introduction and Overview

First, it should be noted that this case is not about the People’s Republic of China (hereinafter referred to as “China”) and its exchange rate policy for the Yuan. In fact, a number of other Countries also run fixed exchange rate schemes (currency pegs) in one way or the other (e.g. Switzerland) or intervene heavily on currency markets (e.g. Japan).

Notwithstanding that, most of the available literature on exchange rate “manipulation” and WTO law concentrates on China. However, the case does not only cover exchange rate manipulation in the sense of setting the exchange rate artificially low, but also raises the question of a dual exchange rate (which could e.g. be found in Myanmar until very recently) and of the legality of measures in order to secure the stability of the national financial sector. Policies like Fixitania’s (recapitalizing, guaranteeing or bailing-out only domestic banks) have been applied by many countries during the course of the global financial crisis (e.g. by Iceland, Ireland etc.).

Regarding most matters raised in the case, no exactly matching WTO case-law exists and most of the questions to be argued by the students’ teams are subject to intense controversy in academic writings as well as political statements by different WTO member governments. Practically all questions can be answered both ways, i.e. an argument can be made in favour of the claimant (Libertania) as well the respondent (Fixitania).

From the point of view of the Case Author, there is no “ideal” or “correct” solution for the case. The following is hence not to be understood as the “model answer” or “model legal
brief, but only as a guide through the maze of applicable provisions of the WTO agreements and the most pertinent legal problems raised or arguments that could be made. The possible arguments presented for both sides are not all equally convincing and some might be stretching the wording of the WTO law provisions substantially. They do not in all cases necessarily reflect the view of the Case Author.

IV. Libertania’s Claim that the REOFI breaches Article XVII of the General Agreement on Trade in Services and Paragraph 2 of its Annex on Financial Services

A. Applicable Provisions of the GATS Legal Framework on Financial Services

Fixitania has made commitments under the GATS in accordance with the “Understanding on Commitments in Financial Services”. In its schedule of specific commitments in the financial services sector, with regard to national treatment restrictions, Fixitania has stated “None”. This should be the basis to assume that the activities of “foreign” commercial banks in Fixitania are in principle covered by commitments of Fixitania under the GATS.

The following legal documents do in principle apply to Fixitania and the REOFI:
The **General Agreement on Trade in Services (GATS)**, as Fixitania is a WTO Member (Art. II:2 and Annex 1B WTO Agreement)

The GATS applies only to measures affecting trade in services (Art. I:1 GATS). Prior to examining a possible infringement of particular provisions of the GATS by the REOFI, **Fixitania must establish that the REOFI constitutes a measure affecting trade in services** (cf. Appellate Body, *Canada – Autos*, paras. 164-166).

The commercial activity of banks in Fixitania is unquestionably a “service” (cf. Art. XXVIII b) GATS), which in this context is provided through the commercial presence (Mode 3, Art. I:2 c) and Art. XXVIII d) GATS) of foreign banks in Fixitania, including banks from Libertania (cf. Art. XXVIII f) (i), l), m), n) GATS); The financial services in question are not “supplied in the exercise of governmental authority” in the sense of Art. I:3 b) GATS as defined in Para. 1 b) of the Annex on Financial Services, as they are provided on a competitive basis (Art. I:3 c) GATS does not apply to financial services, cf. Para. 1 d) of the Annex on Financial Services).

The REOFI is unquestionably a “measure” in the sense of Art. XXVIII a) GATS and it is a measure “affecting trade in services” in the sense of Art. XXVIII c) GATS, given that the Appellate Body interpreted the notion “affecting” broadly (Appellate Body, *EC – Bananas III*, para. 220).

The REOFI is also a measure “by a Member”, since it was enacted by the central government of Fixitania (cf. Art. I:3 a) (i) GATS).

The **Annex on Financial Services**, as it is an integral part of the GATS and binding on all WTO Members (Art. XXIX GATS)

According to the Facts of the Case, Fixitania has made commitments for “financial services”. It should hence not be questioned that the “banks” or “commercial banks” mentioned in the Case are engaged in **activities covered by the specific commitments of Fixitania**.

The Annex on Financial Services only applies to “measures affecting the supply of financial services” (Para. 1 (a) Annex); the only difference to Art. I:1 GATS here is the limitation to “financial services”. The provision should hence generally be interpreted in the same broad way as Art. I:1 GATS.

As the activities by Libertanian banks clearly fall into the scope of “Financial Services” as defined in the Annex (cf. Para 5 a)), the Annex on Financial Services applies to the case as well.
- The *Understanding on Commitments in Financial Services*, as Fixitania has made a reference to that document in its schedule of specific commitments; it is hence binding on Fixitania under Art. XX:3 GATS (regardless of its unclear legal status in the WTO legal framework)

It is clear that non-guaranteed foreign banks as defined in the REOFI do qualify as “non-resident supplier” in the sense of Section D. 1. of the Understanding and as “commercial presence” in the sense of Section D. 2. thereof.

Further documents which are usually mentioned when talking of GATS and financial services are not applicable and of no relevance in the present case. This is the case for

- the *Second Annex on Financial Services*,
- the *Second Protocol on Financial Services* (the so-called “Interim Agreement”) and
- the *Fifth Protocol on Financial Services* (the so-called “Financial Services Agreement”).

None of these documents has been mentioned in the facts of the Case; the Second Annex and the Second Protocol have generally no legal effect any more (except for the Second Protocol for a limited number of WTO Members); whether or not Fixitanias commitments in the sector stem from the Fifth Protocol – which contains no regulatory content as such – or from the original GATS negotiations is of no relevance for the Case.

**B. Libertania’s Claim under Art. XVII GATS**

The first claim made by Libertania addresses the REOFI, according to which savings in F were guaranteed by the FG, but only for banks that were registered in Fixitania and had a majority of domestic shareholders.

Libertania claims that the REOFI breaches

- Article XVII of the GATS and
- paragraph 2 of the Annex on Financial Services.

Libertania does not claim that the REOFI infringes any of Fixitania’s additional obligations under the *Understanding on Commitments in Financial Services* (in particular Section C thereof). No claims are based on Art. XV GATS on subsidies either, as this provision does not contain specific obligations regarding subsidies to service providers. Despite this being so, these provisions may be useful to shed light on the question whether a discriminatory guarantee scheme for banks could be in breach of the national treatment obligation of Article XVII GATS (see paras. 35-38 below).
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Article XVII: National Treatment GATS states:

“1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers. (10)

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

Footnote (10): Specific commitments assumed under this Article shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.”

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The only claim which could legitimately be made in the present case is that Fixitania – by offering guarantees only for deposits made in domestic banks – has treated its domestic banks (as defined in the REOFI) more favourably than like banks of any other Member supplying services through commercial presence in Fixitania. The latter are “juridical persons of another Member” (see para. 19 above).

As has been established by WTO jurisprudence, Libertania, as the complaining party, needs to establish all of the following three elements\(^1\). These three elements must be met cumulatively, i.e. a failure to establish one element would automatically result in a failure to establish the Article XVII claim:

- that Fixitania has made a commitment on national treatment in the relevant sector (Banking and other Financial Services, excluding insurance) and mode of supply (mode 3), regard being had to any conditions and qualifications, or limitations, set out in its Schedule ("none");

According to the Facts of the Case, Fixitania has made commitments in the financial services sector which is – as regards national treatment – not subject to any qualifications or limitations.

- that Fixitania's measures are "measures affecting the supply of services" in the relevant sector and mode of supply; and

This can easily be established as demonstrated in paras. 19-21 above.

- that Fixitania's measures accord to services or service suppliers of any other Member treatment less favourable than the one accorded by Fixitania to its own like services

\(^1\) Panel reports China – Publications and Audiovisual Products, paras. 7.962, 7.970 and 7.972; and China - Electronic Payment Services, para. 7.641
and service suppliers.

There can be no doubt that the legally discriminatory granting of guarantees affects the provision of a service and constitutes “less favourable treatment”. It is also clear from the facts of the Case that the conditions of competition between domestic banks and foreign banks were modified by the REOFI in favour of Fixitanian financial service suppliers (cf. Art. XVII:3 GATS).

Hence, there seems to be a prima facie breach of Art. XVII GATS on the basis of its wording.

Furthermore, in the present case, the provisions of the Understanding on Commitments in Financial Services also need to be taken into account, as they modify or complement the obligations contained in the GATS. In relation to national treatment, Section C.1. of the Understanding stipulates that each Member should grant to financial service suppliers of any other Member established in its territory “access […] to official funding and refinancing facilities available in the normal course of ordinary business”.

Libertania could argue that the guaranteeing of deposits by the Fixitanian Government is equal to or at least resembles “official funding or refinancing”, as deposits are the main refinancing means for commercial banks and the guarantees of the deposits safeguard access to savings and deposits.

Fixitania might reply that the ordinary meaning of the words “official funding and refinancing” does not cover guarantees of deposits. Furthermore, the National Treatment obligation of Section C.1. is limited to “the normal course of business”, whereas the REOFI was enacted to tackle a severe financial crisis, to which the provision arguably does not apply. Moreover, the obligation deriving from Section C.1. “is not intended to confer access to the Member’s lender of last resort facilities”, as which one could also consider the guarantees, given the specific circumstances of the introduction of the measure.

However – Libertania might argue – the REOFI is still in force, even though the situation on the financial markets in Fixitania has stabilized. It is also not entirely convincing to consider the guarantees “lender of last resort facilities”, as this notion usually means facilities which are being provided by a central bank or monetary authority in a situation where market financing dries up. Different from that situation, the REOFI was designed to ensure that market financing (by depositors) would still be available to domestic banks and that the liquidity needs of banks were not overly increased by withdrawals of deposits.

Consequentially, Section C.1. does not conclusively solve the question whether the discriminatory guarantees were a violation of the National Treatment obligation of Art. XVII GATS as detailed in Section C.1.
Presuming that a prima facie violation of Art. XVII GATS may be established by Libertania, Fixitania might rely for the justification of the discriminatory deposit guarantees on Para. 2 a) of the Annex on Financial Services, the so-called “prudential carve-out”, which stipulates:

“Nowithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. […]”

In order to provide a justification for a breach of Art. XVII GATS, it would be necessary for Fixitania to argue that the prudential carve-out serves as an exception or affirmative defence, a reading supported by the starting sentence of the reference to “Member’s commitments or obligations”. Furthermore, it would be necessary that the guaranteeing of deposits is a “measure for prudential reasons”. The goal of the REOFI certainly warrants such interpretation (protection of depositors and ensuring the integrity and stability of the financial system). “Prudential” means “of, pertaining to, characterized by, or resulting from prudence”, whereas “prudence” is e.g. defined as “care, caution, and good judgment, as well as wisdom in looking ahead”. Fixitania should argue that it guaranteed the deposits out of prudence, i.e. in order to prevent a melt-down of its financial system that could have been triggered by a bank run.

However, Libertania might reply that it is questionable – against the backdrop of the usual meaning of “prudential”, whether a guarantee scheme can qualify as a “prudential measure”. Prudential measures would normally be regulatory measures that impose certain duties on banks in order to take care of risks that may arise (e.g. licence or capital requirements). Such narrower interpretation would also be supported by looking at the heading of Para. 2 of the Annex on Financial Services (“Domestic Regulation”) which refers rather to Art. VI GATS. Furthermore, it demonstrates that the prudential carve-out cannot justify discriminatory measures as in the case at hand. For prudential reasons, it would have been much more effective if deposits with foreign banks had also been guaranteed.

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3 Ibid.
4 In order to further substantiate the meaning of the term “prudential”, one could also take a look into the practice of other international organizations occupied with banking supervision such as the BIS’ Basel Committee (this informative approach would not raise the difficult question concerning the relationship between WTO rules and other international agreements, in which context it would be relevant whether the parties to the dispute (or all WTO Members) are parties to these other agreements).
Furthermore, **Libertania also claims** that Fixitania has breached its obligation under Paragraph 2 of the Annex on Financial Services. As the provision mainly contains a justification for Members taking measures otherwise in conflict with the GATS (see paras. 31-32 above), this claim can only be interpreted as referring to the second sentence of Para. 2 a), which reads:

"Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement."

A breach of this provision, insofar as it can be interpreted as laying down an independent obligation and not only an exception from the prudential carve-out proviso of sentence 1, would require that the REOFI’s guarantee scheme did qualify as a prudential measure (see above), that it does not conform with the GATS (see above) and that it was used by Fixitania to avoid its commitments or obligations under the GATS.

It is not clear from the Annex what exactly is meant by “avoiding”. In academic writings, it is suggested that the term should be interpreted like the Chapeau of Art. XX GATT or that it constitutes at least some kind of reasonableness/proportionality test, i.e. that it requires looking at whether the regulatory goal is genuinely pursued, the proportionality of the measure and whether it contains an “unjustifiable discrimination”. This would of course be a difficult balancing exercise.

**Libertania should argue** that in international banking practice, it is rather for the host Country regulator to guarantee for domestically incorporated foreign banks and for the home Country to guarantee mere branches in foreign Countries.

**Fixitania** could point out that the general approach of the Annex on Financial Services as well as of the Understanding rather supports a reading that WTO Members have no responsibility for bailing-out foreign banks that do business in their jurisdiction (cf. the proviso on the lender-of-last resort facilities). That argument could then also be made with regard to guarantee schemes.

### C. Further Counterarguments by Fixitania regarding Art. XVII GATS

Fixitania might further argue that the **discriminatory guarantees constitute subsidies, which are not subject to specific disciplines under the GATS** (taking the definitions contained in Art. 1.1 of the Agreement on Subsidies and Countervailing Measures (ASCM) into account; *in concreto* the guarantees could qualify as a potential direct transfer of funds (Art. 1.1 (a)(1) (i) ASCM) or a government service (Art. 1.1 (a)(1) (iii) ASCM) that confers a benefit (Art. 1.1 (b) ASCM) as it is free-of-charge (whereas an insurance or similar guarantee on private markets would normally come at a price)).

**The GATS does not rule out subsidies to service suppliers in any strict legal way.** It only presents a basis for negotiations on subsidies disciplines (Art. XV:1 GATS) and provides...
for consultations in case a Member considers to be adversely affected by another Member’s subsidies.

This does, however, not mean e contrario that subsidies to service suppliers are always legal under the GATS. Libertania should reply that the national treatment obligation applies — irrespective of Art. XV GATS — also to subsidies. This argument is supported by the wording of Art. XVII GATS (which has no exception for subsidies) and the practice of WTO Members, demonstrated also in the following document.

The WTO document “Scheduling of Initial Commitments in Trade in Services. Explanatory Note” stipulates:

“16. Article XVII applies to subsidies in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines" to counter the distortive effects caused by subsidies and does not contain a definition of subsidy. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidies are also not excluded from the scope of Article II (MFN). In line with the paragraph above, a binding under Article XVII with respect to the granting of a subsidy does not require a Member to offer such a subsidy to a services supplier located in the territory of another Member.”

A limitation to that obligation is contained in paragraph 10 of the said document:

“10. There is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service supplier located in the territory of another Member.”

Under this limitation, hence, service suppliers operating under Mode 1 or 2 could not complain about discriminatory granting of subsidies, whereas service suppliers operating under Mode 3 or 4 could complain.

Hence, Libertania should argue, the discriminatory granting of subsidies as in the present Case could constitute a breach of the national treatment obligation of Art. XVII GATS.

V. Libertania’s Claims regarding the FSEGSJ

A. Libertania’s Claim that the FSEGSJ breaches provisions of the ASCM

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5 WTO-Document S/L/92.
1. Overview

Libertania claims that Fixitania breaches the Agreement on Subsidies and Countervailing Measures in conjunction with Art. VI and XVI GATT, since the dual exchange rate regime constitutes a prohibited export subsidy. This goes in line with a core allegation that is being made in the USA and in academic writing alike with regard to China’s currency peg that allegedly leads to an undervaluation of the Chinese Renminbi against the US-Dollar. Hence, there is plenty of literature available on the subject. A major difference between the arguments presented in that literature and the Facts of the Case should not be overlooked, though. Whereas China only has one exchange rate for the Renminbi (allegedly manipulated), Fixitania runs a dual exchange rate regime where the undervalued rate is only available for ENRs, i.e. for undertakings exporting from Fixitania. This makes a major difference (in favour of Libertania) when arguing whether there is a financial contribution by the government, whether a benefit is thereby conferred and whether this is export contingent.

Economically, it is usually being argued that an undervalued exchange rate has an effect at least similar to an export subsidy, as it makes exports “cheaper”. However, this argument is far from undisputed. The counterargument often made is that absent domestic price controls the price levels – at least in the medium to long run – would adapt to the “manipulated” exchange rate. A further complication is added if undertakings – as in the present Case – may invoice either in domestic or in foreign currency. The teams should focus their economic arguments in that regard on the criteria “benefit” and “in law or in fact contingent upon export performance”.

In the answers to the Clarification Requests, it was made clear that the claim of Libertania is limited to a prohibited export subsidy and that the question of whether it could also constitute an actionable subsidy was not to be addressed (as there were also no sufficient data made available in the Facts of the Case).

2. Criteria for a Prohibited Export Subsidy

The relevant provisions for the assessment of Libertania’s claim are laid down in Art. 1, 2 and 3 ASCM. The mentioning of Art. VI and XVI GATT in the complaint is of no particular relevance, as these provisions do not contain any rules applicable to export subsidies (Art. VI GATT) or rules which are significantly less strict than the more specific rules of the ASCM. Nevertheless, as the ASCM specifies the application of Art. VI and XVI GATT, the quotation is not entirely unjustified, in particular as Art. VI and the ASCM are considered an inseparable package of legal obligations. In any case, the provisions of the ASCM would prevail in the

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case of a conflict between them and the GATT.\footnote{Cf. General interpretative note to Annex 1A of the Agreement establishing the World Trade Organization (WTO).}

Art. 1 through 3 ASCM (including footnotes and Annex 1) read as follows:

Part I: General Provisions

**Article 1: Definition of a Subsidy**

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

   (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where:

      (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);

      (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)\footnote{(1)};

      (iii) a government provides goods or services other than general infrastructure, or purchases goods;

      (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one 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) 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.

1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

\footnote{(1) In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.}

**Article 2: Specificity**

[...]

2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.
Part II: Prohibited Subsidies

Article 3: Prohibition

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact\(^{(4)}\), whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I\(^{(5)}\);

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

\(^{(4)}\) This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

\(^{(5)}\) Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

Annex I: Illustrative List of Export Subsidies back to top

(a) [...]  
(b) Currency retention schemes or any similar practices which involve a bonus on exports.  
(c)-(l) [...]  
(j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.  
(k) [...]  
(l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994.

Libertania would hence have to establish that the dual exchange rate fulfills the criteria of Art. 1, 2 and 3 ASCM,

- that it constitutes a **subsidy** as defined in Art. 1.1 ASCM, i.e.
  - a **financial contribution** by a public body (Art. 1.1 (a) ASCM) or **price support** (Art. 1.1 (b) ASCM), and
  - a **benefit** is thereby conferred (Art. 1.2 ASCM)

- that it is **in law or in fact, solely or as one of several other conditions, contingent upon export performance** (Art. 3.1 (a) ASCM).

It is not necessary that the alleged benefit is specific in the sense of Art. 2 ASCM, as Art. 2.3 ASCM provides that every prohibited subsidy is to be deemed specific.
3. Possible Arguments in Favour of Libertania’s Claim

- **Libertania should argue** that the buying of foreign currency by the FCB amounts to a financial contribution by a government or public body. The FCB is clearly presented as an agency of the Fixitanian Government (it is established by law, owned by the Government and under the authority of the Minister of Finance) or an organ of Fixitania in the Facts of the Case (cf. also Art. 4 and Art. 5 of the Draft Articles on State Responsibility, reflecting customary rules or general principles of international law).

- **Libertania should argue** that the dual-exchange rate constitutes a direct transfer of funds (Art. 1.1 (a) (i) ASCM). The FCB pays Fixis to ENRs against them surrendering their foreign reserve income.

- **Libertania could further argue**, as the profits of the FCB are ultimately going into the official budget of Fixitania, the financial loss caused by buying at non-market rates reduces the monetary income of the FCB and hence the transferable profit. Consequentially, one could argue that this amounts to not collecting government revenue otherwise due (Art. 1.1 (a) (ii) ASCM); the problem with this argument is that the exchange of foreign currency resembles a commercial transaction and the revenue stemming from that is not really “due” in the ordinary sense of the term.

- Furthermore, **Libertania could argue**, the exchange services provided by the FCB could be qualified as government services other than general infrastructure (Art. 1.1 (a) (iii) ASCM) or as purchase of goods (Art. 1.1 (a) (iii) ASCM), even though money is not normally considered a “good” (but the payment for a good).

- **Libertania should argue** that a benefit is thereby conferred as ENRs receive more Fixis for the foreign currency they have earned than non-ENRs do receive on the FCM (and more than they would have received under real market conditions of fluctuating exchange rates for all sorts of transactions). The financial contribution by the FCB which ENRs receive is hence more favourable than in the market.

- **Libertania could further argue** that the notion “subsidy” does not only cover actual payments but also “measures having an equivalent effect”. Hence, it would only be relevant if a benefit is conferred by Government action irrespective of whether it involves actual payments. This is confirmed by Appellate Body jurisprudence, which states that the emphasis should be on the recipient rather than the Government and that the term benefit does not require actual costs on the part of

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the Government.\textsuperscript{10}

- Libertania should argue that the subsidy is legally contingent on export performance, as it is only available to ENRs, i.e. to exporting undertakings, and that it is contingent on export performance as the actual benefit conferred depends on the revenues deriving from export transactions.

- Libertania could also argue that – if the subsidy is not found to be legally contingent on export performance – the subsidy is at least de facto contingent on export performance, as it fulfills the criteria of footnote 4 to the Article, i.e. it is “in fact tied to actual or anticipated exportation”. The benefit is also contingent on exportation, as the dual exchange rate system favours only ENRs, but not capital importers or tourists etc. The relevant legal test here was established by the Appellate Body in EC – Aircraft:\textsuperscript{11}

\textit{“Is the granting of the subsidy geared to induce the promotion of future export performance by the recipient?”} This standard would be met "when the subsidy is granted so as to provide an incentive to the recipient to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy"; The existence of de facto export contingency "must be inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy."

This may include the following factors:

"(i) the design and structure of the measure granting the subsidy;

(ii) the modalities of operation set out in such a measure; and

(iii) the relevant factual circumstances surrounding the granting of the subsidy that provide the context for understanding the measure’s design, structure, and modalities of operation”;

In sum: “Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement”.

- Libertania might finally argue that the ad note to Article VI:2 and 3 of the GATT confirms that multiple exchange rates can be prohibited export subsidies:

\textit{“Ad Article VI}

\footnote{\textit{Appellate Body Report, Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R, paras. 154 et seq.}}

\footnote{The following subparagraphs have been taken (and slightly modified) from worldtradelaw.net Case Law Index for Art. 3 ASCM}
Paragraphs 2 and 3

1. As in many other cases in customs administration, a contracting party may require reasonable security (bond or cash deposit) for the payment of anti-dumping or countervailing duty pending final determination of the facts in any case of suspected dumping or subsidization.

2. Multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 or can constitute a form of dumping by means of a partial depreciation of a country’s currency which may be met by action under paragraph 2. By “multiple currency practices” is meant practices by governments or sanctioned by governments.”

- Libertania could note in this regard that Art. VI and the Agreement on Subsidies and Countervailing Measures are an inseparable package of rights and obligations that must be considered in conjunction.

4. Possible Counterarguments by Fixitania

- Fixitania might argue that the Panel Request of Libertania is not sufficiently precise to pass the test established by the Panel in EC-Bananas III, as it does not specify which provision of the ASCM Libertania claims to be violated by the exchange rate regime. The relevant passage reads as follows:

“The panel request alleges an inconsistency with the requirements of the Agreement on Agriculture, without specifying any provision thereof. It also states that ‘the EC’s measures are inconsistent with the following Agreements and provisions among others’, suggesting that there may be inconsistencies with unspecified agreements and inconsistencies with unspecified provisions of the specified agreements. In these two situations, it is not possible at the panel request stage, even in the broadest generic terms, to describe what legal ‘problem’ is asserted. While a reference to a specific provision of a specific agreement may not be essential if the problem or legal claim is otherwise clearly described, in the absence of some description of the problem, a mere reference to an entire agreement or simply to ‘other’ unspecified agreements or provisions is inadequate under the terms of Article 6.2. Accordingly, we find that references to a WTO agreement without mentioning any provisions or to unidentified ‘other’ provisions are too vague to meet the standards of Article 6.2 of the DSU.”

- However, Libertania should counter argue that Art. 6.2 DSU only requires to provide “a brief summary of the legal basis”, not the mentioning of specific provisions to be violated. Furthermore, Libertania should point out that the reasoning the Panel applied in EC – Bananas III does not fit the present situation, as the claims by

Libertania are at least sufficiently precise “to describe what legal problem is asserted”.

- **Fixitania should argue** that Art. 1.1 (a) (1) ASCM contains an exhaustive list of covered financial contributions and the exchange rate measure does not fall into any of the listed categories.
  
  - It does not involve a direct *transfer* of funds, as the examples listed in Art. 1.1 (a)(1)(i) ASCM are of an entirely different nature (grants, loans, equity infusion) than a mere foreign exchange transaction (which rather involves an *exchange of funds* than a transfer).
  
  - It does not constitute the *foregoing or not collecting of government revenue otherwise due* (Art. 1.1 (a)(1)(ii) ASCM) as the notion “revenue due” implies some kind of legal obligation of the parties involved to make payments to the Government (e.g. taxes); that is obviously not the case here.
  
  - Whereas the exchange service as such might be considered a service (Art. 1.1 (a)(1)(iii) ASCM), this is not the case for the setting of the exchange rate; also, the Fixis handed out by the FCB in exchange for foreign currency are not “goods”.
  
  - Fixitania should also argue that the dual exchange rate system was *general infrastructure* provided by Fixitania in the same way as education, railways etc. and not covered by the notion “subsidy” (cf. Art. 1.1 (a) (iii) ASCM). This would concur with the Airbus panel’s reading of the term “general infrastructure”\(^\text{13}\), as the exchange rate is available for nearly all undertakings.

- **Fixitania should further argue** that – assuming that there might be non-listed types of financial contributions – the buying of foreign currency from ENRs by the FCB does *not constitute a financial contribution*, as the FCB receives foreign reserves against domestic currency and – different from the Government – the FCB can produce the domestic currencies itself as part of its monetary policy, i.e. it does not effectively bear any costs by buying foreign currency. Furthermore, Fixitania could point out that the market rate is not a suitable benchmark for comparison to determine whether a benefit is conferred, as the market’s volatility indicates that there is no objectively correct exchange rate.

- **Fixitania might also argue** that the same reasoning (regarding the market rate being inadequate) does also apply to the claim regarding the foregoing of revenue otherwise due. It is simply impossible to identify the “revenue otherwise due”.

- **Fixitania should further argue** that *no benefit is conferred* by the dual exchange rate regime as ENRs are under an obligation to exchange their foreign currency revenues and the exportation of capital is restricted; as a consequence, the exchange rate regime rather limits the business opportunities of ENRs than to enhance them.

Furthermore, Fixitania should argue that it is impossible to tell the “correct” value of the Fixi and therefore it would be impossible to determine the amount of the benefit allegedly conferred. In addition to that, Fixitania could argue that the dual exchange rate regime is not beneficial for traders as they keep adjusting their prices to the rate and some of them may invoice in Fixi (thereby not generating foreign currency revenue). As a consequence, there would be no price difference between the domestic market in Fixitania and world markets (the latter being the characteristic feature of export subsidies as described in Art. XVI:4 GATT)

- Fixitania should also argue that – if the exchange rate system constituted a subsidy – it is not de jure or de facto export contingent as ENRs could also have revenue from other sources than export of goods, e.g. trade in services, investment income or IP license fees. Whereas the fixed exchange rate is only available to exporters, it is not limited to exports.

- Fixitania should then argue that the dual exchange rate is not an export subsidy, as it is not mentioned in the List contained in Annex 1 of the ASCM, even though currency undervaluation has always been a well-known instrument to influence trade flows. The List mentions currency retention schemes, which are, however, only being used in situations of overvalued currencies (not undervalued as the Fixi). In such cases, there will normally be a legal obligation to surrender all foreign currency income to the monetary authorities. The retention scheme would make it possible for beneficiaries to keep some of the foreign currency earned (the benefit). The dual exchange rate regime can also not be qualified as an exchange risk programme under Annex 1 (j). One could argue that measures not mentioned on the list are e contrario not to be considered export subsidies. The counterargument of Libertania would be that the list is only illustrative and that the actual legal conditions flow from Art. 1 and Art. 3 ASCM.

B. Libertania’s Claim that the FSEGSJ breaches Art. XV of the GATT (in conjunction with the IMF Articles of Agreement)

1. Overview

Libertania’s claim against the FSEGSJ under Art. XV GATT is also extremely complicated, as most of the notions of Art. XV GATT are unclear and uncertain as to their precise meaning. This is particularly true for the notion “exchange action”. Furthermore, it must be examined what relevance shall be given to possible infringements of the IMF Articles of Agreement by Fixitania.

14 Under a currency retention scheme, undertakings are under a general obligation to deliver their foreign currency reserves to the monetary authorities, but they may retain a certain amount. This is not the system as operated by Fixitania.
2. *Excursus: The FSEGSJ under the IMF Articles of Agreement*

A possible conflict of the FSEGSJ with Fixitania’s obligations deriving from its Membership in the International Monetary Fund (IMF) cannot, of course, be subject of as WTO challenge a such, as the IMF Articles of Agreement are not one of the “covered agreements” mentioned in Art. 1.1 of the Understanding of the Settlement of Disputes (DSU). Nevertheless, it might be useful in advance to shed some light on the possible assessment of the FSEGSJ under the IMF Articles of Agreement, as this may be of influence for the interpretation of certain notions contained in particular in Art. XV GATT, following the approach the Appellate Body took with regard to the New York Convention on the Trade in Endangered Species (CITES) in *US – Shrimps*.

Generally, IMF members may choose an exchange rate regime they deem fit for their respective economic situation, including a currency peg against other currencies (Art. IV Section 2 (b) (i) IMF). However, their room for maneuver is limited by Art. IV Section 1 IMF.

The relevant provision of the IMF Articles of Agreement reads as follows:

**Article IV: Obligations Regarding Exchange Arrangements**

*Section 1. General obligations of members*

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 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.

The most relevant passage of Art. VI Section 1 is to be found in paragraph (iii). The precise meaning of the obligation to avoid an exchange rate manipulation is highly disputed and subject to a further clarification contained in the IMF Executive Board Decision on Bilateral and Multilateral Surveillance (on the basis of Art. VI Section 3 (b) IMF). The original
decision of 1977 was replaced in 2007. The latter decision has again been replaced in 2012, but the relevant content for the Case at hand has not changed significantly (which means also that the teams do not need to indulge into the question of applicability rationae temporis). The decision does not impose additional obligations on IMF members; moreover, it provides “guidance” for the Fund in its surveillance, and also to IMF Members in the conduct of their relevant policies.

On the basis of these documents, it is only clear that:

- Art. VI Section 1 (iii) IMF contains a hard legal obligation of IMF Members.
- Art. VI Section 1 (iii) IMF requires two conditions to be fulfilled for an exchange rate policy to be in breach of the obligation; firstly, an objective element (“manipulation of exchange rates”) and, secondly, a subjective element (“in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members”).

It is unclear, however,

- whether the legal obligations of IMF Members under the IMF Articles of Agreement exist only vis-à-vis the IMF or also vis-à-vis other IMF Members; this could be of relevance in interpreting the obligations under the GATT (as it would raise the question whether Libertania could rely on a possible breach of the IMF Articles of Agreement at all, even if only indirectly via Art. XV GATT).

The clarifications to Art. IV Section 1 (iii) IMF are laid down in Part II, paragraphs 19-23 of the 2007/2012 decision. In these paragraphs, the Decision establishes five principles that apply to the conduct of exchange rate policies. Two of these principles are of particular interest in the present case:

“**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.**

[...]**

**D. A member should avoid** exchange rate policies that result in balance of payments instability.”
The Decision further stipulates:

“22. 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;

• (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.”

An Annex to the 2007/2012 Decision adds further clarifications with regard to Principle A of the Decision. It reads:

“Article IV, Section 1(iii) and Principle A

1. Article IV, Section 1 (iii) of the Fund’s Articles provides that members shall “avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” The language of this provision is repeated in Principle A contained in Part II of this Decision. The text set forth below is designed to provide further guidance regarding the meaning of this provision.

2. A member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund determined both 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).

(a) “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.

(b) 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.

3. It is the responsibility of the Fund to make an objective assessment of whether a member is observing its obligations under Article IV, Section 1 (iii), based on all available evidence, including consultation with the member concerned. Any representation made by the member regarding the purpose of its policies will be given the benefit of any reasonable doubt."

Assessing Fixitania’s fixed exchange rate on this basis is by no means an easy task. It seems rather obvious, though, that Fixitania fulfills most of the objective criteria set for the determination of an objective exchange rate manipulation. This is based on the following considerations:

- Fixitania’s policy is targeted at the level of the exchange rate and actually affects it;
- It suffices that the policy prevents a movement of the exchange rate;
- Fixitania is engaging in large protracted interventions in the exchange markets in one direction;
- It has accumulated large amounts of foreign assets;
- It has restricted capital inflows (and payments and current transactions for some time);
- There is a fundamental misalignment of the exchange rate of the Fixi;
- There is a large current account surplus;

However, what is much more difficult to demonstrate is the subjective criterion, i.e. that Fixitania engaged in this policy “in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members”. This is particularly true as – under the Decision –

“[m]embers are presumed to be implementing policies that are consistent with the Principles.” (paragraph 20)

Furthermore,

“[w]hen [...] 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 a fundamental exchange rate misalignment.” (ibid.)
Given the particular economic situation in which Fixitania has made its initial decision to switch to its new exchange rate regime, the Fund would arguably not arrive at a finding of an illegal fully-fledged exchange rate manipulation in the sense of Art. IV Section 1 (iii) IMF (no such finding has ever been made by the IMF). At any rate, it would only engage in consultations with Fixitania about how to address the situation and how to move to more flexible, less IMF-inconsistent exchange rate regime (this has happened on a limited number of occasions over the last forty years of surveillance).

Notably, the IMF has not arrived at such conclusion in the Facts of the Case.

A further question arises with regard to the dual exchange rate regime established by the FSEGSJ. Insofar, one might argue that this would be contrary to Fixitania’s obligations under Art. VIII IMF. This proviso stipulates:

“Article VIII: General Obligations of Members

Section 1. Introduction

In addition to the obligations assumed under other articles of this Agreement, each member undertakes the obligations set out in this Article.

Section 2. Avoidance of restrictions on current payments

(a) Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

(b) Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Section 3. Avoidance of discriminatory currency practices

No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1 to engage in, any discriminatory currency arrangements or multiple currency practices, whether within or outside margins under Article IV or prescribed by or under Schedule C, except as authorized under this Agreement or approved by the Fund. If such arrangements and practices are engaged in at the date when this Agreement enters into force, the member concerned shall consult with the Fund as to their progressive removal unless they are maintained or imposed under Article XIV, Section 2, in which case the provisions of Section 3 of that Article shall apply.”

The notion “discriminatory currency arrangements” is usually interpreted as meaning currency practices which favour certain other currencies, e.g. through the conclusion of bilateral payments agreements. As the FCM and the fixed exchange rate, however, are open
to transactions irrespective of the geographical origin of the currency exchanged, Fixitania has not engaged in a “discriminatory currency arrangement”. The pegging of the Fixi against the Libertado does not amount to such arrangement, as the pegging against certain individual currencies or baskets of currencies is explicitly foreseen in the IMF Articles of Agreement (Art. IV Section 2 (b) (i) IMF).

However, the dual exchange regime with the fixed rate and the FCM is arguably a “multiple currency practice” in breach of Art. VIII Section 3 IMF. The IMF Articles of Agreement do not contain a formal definition of the notion; however, there is wide agreement that “the essential characteristic of a multiple currency practice is the existence of two or more exchange rates which are independent of each other and which apply to different categories of exchange transaction”.

Currency practices that involve different rates for the currency depending on the way it was earned or the purpose for which it is used clearly breach Art. VIII Section 3 IMF except as authorized by the IMF agreement or approval of the Fund. As there has been no authorization by the Fund in the present Case, Fixitania violates Art. VIII Section 3 IMF. The same would also be true for the restrictions on payments that were introduced by Fixitania without formal approval by the Fund (no such approval is mentioned in the Facts and the respective clarification requests).

However, as Libertania is only arguing that Fixitania is engaging in exchange rate manipulation but not in multiple currency practices, this would not necessarily have to be addressed by teams in their briefs.

In sum, there is no clear-cut argument that Fixitania is indeed breaching its obligations under Art. IV Section 1 (iii) IMF (manipulation of the exchange rate), but convincing arguments to assume that Fixitania has breached its obligations under Art. VIII Section 3 IMF (and possibly Section 2) IMF. As such, this finding is irrelevant for the claims of Libertania, as an isolated breach of an agreement not covered by the DSU cannot give rise to any claims before the WTO dispute settlement organs. However, Libertania only claims that Fixitania has breached Art. XV GATT in conjunction with the IMF Articles of Agreement.

3. Introduction to Art. XV GATT

Paragraphs 1 through 3 and 5 of Art. XV GATT only address the CONTRACTING PARTIES, Libya, and certain aspects of treaty obligations. Therefore, it is not directly relevant to the current analysis.

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i.e. the WTO as a whole (see GATT 1994, Introduction, paragraph 2 (b)). Obligations of Contracting Parties, i.e. of WTO Members, are only laid down in Art. XV:4, Art. XV:6 and Art. XV:8 GATT. Obviously, only Art. XV:4 GATT can be of relevance here; it is also at the heart of most scholarly treatments of the exchange rate manipulation discussions. Furthermore, Art. XV:9 a) GATT may be invoked as a justification by Fixitania.

Libertania claims that Fixitania has violated Art. XV:4 GATT in conjunction with the provisions of the IMF Articles of Agreement.

Art. XV:4 GATT states:

“4. 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.

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Ad Article XV, Paragraph 4

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 Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund 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 licence the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.”

Art. XV:4 GATT has never been invoked in GATT/WTO dispute settlement and there is hence no guidance available from Panels or the Appellate Body, nor from any other WTO body.

Of the two alternatives of the provision, Libertania can only claim that Fixitania has “by exchange action” “frustrated the intent of the provisions of this Agreement”, as there has been no mentioning of any “trade action”, i.e. trade restrictions etc. Libertania and Fixitania, hence, must focus in their pleadings on these two aspects:

- whether or not the exchange rate regime, i.e. the fixed exchange rate for export transactions, is “exchange action”
- whether or not it “frustrates the intent of the provisions of the GATT”

Besides Art. XV:4 GATT, Fixitania might also invoke Art. XV:9 (a) GATT as a justification of the exchange rate regime.
Art. XV:9 (a) GATT reads:

“9. Nothing in this Agreement shall preclude:

(a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party’s special exchange agreement with the CONTRACTING PARTIES”.

As regards the obligation of the WTO to consult fully with the IMF and to accept all findings by the IMF which is enshrined in Art. XV:2 GATT, the Facts of the Case make it clear that consultations by the Panel have taken place (without specifying the legal basis). The dispute, whether Art. XV:2 GATT also applies in dispute settlement proceedings may be touched upon by the teams, but it is unnecessary to do so. All Facts of the case make it clear that the Fixi is overvalued. However, no finding of IMF inconsistency has been communicated by the IMF, so the matter is entirely left to the panel. Teams may, though, address the question to what extent the “findings” by the IMF are binding on the Panel.

4. Possible Arguments in Favour of Libertania’s Claim Regarding Art. XV GATT

Libertania must establish cumulatively that the exchange rate regime of Fixitania

- can be subject to a WTO challenge,
- is “exchange action” in the meaning of Art. XV:4 GATT, and
- that it frustrates the intent of the provisions of the GATT.

a) Fixitania’s exchange rate regime in the WTO Dispute Settlement Mechanism

- Libertania should argue that Art. XV:4 GATT establishes an obligation of WTO law which is generally independent of the IMF’s assessment as to the legality of a specific exchange rate regime, i.e. even though a certain policy might not be infringing the IMF Articles of Agreement, it might still be breaching the WTO Agreements; this view would in particular be supported by the wording of Art. XV:4 GATT (militating for an independent legal obligation) and the justification proviso in Art. XV:9 (a) GATT (which would be rendered unnecessary if Art. XV:4 GATT was not interpreted to contain an obligation).

- Libertania should argue that the WTO can be the forum for the discussion (and litigation) of measures falling also into the jurisdiction of the IMF. This position is supported in particular by Art. XV:2 GATT, as the procedural obligations laid down therein would be unnecessary if the WTO was not to deal with exchange matters at all.
These arguments are all the more stronger considered that Fixitania’s exchange rate regime is (at least because of the dual exchange rate) most likely IMF illegal, even if the rules of the IMF do not provide for a formal finding to that end. The general idea of Art. XV GATT would only be to prevent IMF-consistent measures from challenge within the WTO.

b) Fixitania’s exchange rate regime as “exchange action” – Arguments

Libertania should argue that the term “exchange measure” in Art. XV:4 GATT should be interpreted based upon its ordinary meaning, its context, and the object and purpose of the provision.\footnote{For this general methodological approach cf. Appellate Body Report, Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R, para. 91.}

It should further argue that the ordinary meaning of “exchange action” is broad and also covers all measures in relation to the exchange rate; looking at other provisions of the GATT that relate to “exchange”, one can find references to “exchange matters”, “exchange controls” and “multiple exchange rates”, “foreign exchange arrangements” etc.; had the drafters of the GATT intended to give Art. XV:4 GATT a narrow meaning, they could have chosen other terms which have a narrower meaning.

Libertania could also point to the specific design of the Fixitania exchange rate regime that consists not only of a fixed exchange rate and heavy interventions by the FCB, but also a dual exchange rate which is – arguably – contrary to the IMF Articles of Agreement (see above paras. 48-64); multiple currency practices are covered by Art. XV:9 (a) GATT, as can be inferred from the Ad note to Art. VIII GATT, which reads:

“1. While Article VIII does not cover the use of multiple rates of exchange as such, paragraphs 1 and 4 condemn the use of exchange taxes or fees as a device for implementing multiple currency practices; if, however, a contracting party is using multiple currency exchange fees for balance of payments reasons with the approval of the International Monetary Fund, the provisions of paragraph 9 (a) of Article XV fully safeguard its position.”

The same conclusion can be drawn from the mentioning of multiple exchange rates in the Ad note to Art. VI paragraph 2 and 3 (see para. 45 above).

\emph{E contrario} one could draw the conclusion that dual exchange rates are also covered by Art. XV:4 GATT, as there would otherwise be no need to include them into Art. XV:9 (a) GATT.
Libertania should also argue that the drafting history of Art. XV GATT confirms (in line with Art. 32 of the Vienna Convention on the Law of Treaties) an interpretation that includes exchange rate policies and point, e.g. to John Jackson’s statement to that end in his “World Trade and the Law of GATT” (1969), p. 479.\textsuperscript{18}

c) Frustration of the Intent of the Provisions of the GATT

Libertania should argue that the prohibition on “frustration” applies – despite the wording “this Agreement” – not only to the GATT, but also to the other WTO agreements, e.g. the ASCM, as the GATT 1994 is an integral part of the WTO legal framework;

Furthermore, Libertania should argue that a frustration of the intent of the provisions of the WTO Agreements does not require a violation of any provision by a measure; according to this view, “frustration” (in line with its ordinary meaning) means less than a full-fledged infringement; Fixitania should counter argue by pointing to the wording of the Ad note which explicitly requires a violation (and has the effect that not every violation amounts to frustration). Libertania should respond that the Ad note has only an indicative, non-conclusive character, as demonstrated by the words “for example”; it should further argue that the frustration of the intent of any single provision of the WTO agreements would suffice for a violation of Art. XV:4 GATT and that it is not necessary that a measure frustrates the intent of the WTO Agreements taken as a whole. Fixitania might then reply that a reading of Art. XV:4 GATT that would not require a violation of another GATT provision would transform Art. XV:4 GATT into a special “non-violation complaint” similar to Art. XXIII:1 b) or c) GATT, which would be largely useless (as the situations would always already be covered by Art. XXIII:1 b) or c) GATT).

Libertania should then argue that the exchange rate regime has the same economic effect as a tariff-cum export subsidy, frustrating the market access and export subsidy commitments of the GATT and other WTO Agreements. Specifically, it is being argued that an undervalued exchange rate would frustrate the intent of Art. II:7 GATT (tariff commitments)\textsuperscript{19} and of Art. XVI GATT and the ASCM provisions on export subsidies, i.e. in particular Art. 3 ASCM.\textsuperscript{20} Furthermore, it is put forward that

\textsuperscript{18} The passage reads as follows: “It was well recognized at the time of drafting GATT that currency par value manipulation and exchange controls could used to protect domestic markets against imports. In the 1945 legislative history of the act authorizing United States participation in GATT, congressional complaints against foreign use of these devices were strong. The GATT draftsmen, particularly the American delegates, felt constrained to include some protection against them in the tariff agreement, even though the International Monetary Fund articles contained some similar provisions.”

\textsuperscript{19} Because an undervalued exchange rate makes imports more expensive in domestic currency.

\textsuperscript{20} Because an undervalued exchange rate makes exports less expensive in foreign currency.
the general intent of the GATT was “balanced trade”, which would be frustrated if there were persistent trade-surpluses (as a consequence of exchange action).

5. Possible Counterarguments by Fixitania Regarding Art. XV GATT

Fixitania will argue

- That Art. XV:4 GATT cannot serve as a basis for a claim of WTO illegality.
- that the exchange rate regime is not an “exchange measure” in the meaning of Art. XV:4 GATT, and
- that it does not frustrate the intent of the provisions of the GATT.
- the exchange rate regime is justifiable under Art. XV:9 (a) GATT directly or by analogy.

a) Art. XV:4 GATT as a basis of a WTO claim

- Fixitania could possibly argue that the WTO is not the right forum for a dispute about an exchange rate regime; according to this view, all questions governed by IMF law should be dealt with exclusively in the IMF; the argument would draw on the general orientation of Art. XV GATT and the explicit carve-out in Art. XV:9 IMF, but it is weaker than Libertania’s arguments in that regard.

b) Fixitania’s exchange rate regime as an “exchange measure”

- The wording “exchange action” can also be construed narrowly as referring only to “exchange policies” in the IMF sense (which is the question of convertibility) but not to “exchange rate policies”, in particular as at the time of drafting of the GATT the IMF Articles of Agreement were still based on a fixed exchange rate system with par values of currencies; under that system, IMF members had to seek permission by the IMF for revaluations. The GATT makes repeated reference to these “par values” (cf. e.g. Art. II:6 (a) and Art. VII:4 (a) GATT).

- Fixitania could also point to the negotiating history and the fact that in the Havana Charter negotiations, proposals for a “currency dumping duty” were discussed, but were dismissed in the final GATT negotiations. This would confirm (in line with Art. 32 of the Vienna Convention on the Law of Treaties) the interpretation that exchange rates are not covered by Art. XV:4 GATT.

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21 See The Relationship between Exchange Rates and International Trade – Exchange Rate Misalignment and Trade Remedies: A Conceptual Note by Brazil, WT/WGTDF/W68, p. 2.
c) **Frustration of the Intent of the Provisions of the GATT**

- Fixitania should also argue that there is no frustration of the intent of any GATT provisions in the sense of Art. XV:4 GATT, as the Ad note makes it very clear that the concept of “frustration” in Art. XV:4 GATT is narrower than a mere breach of a provision, i.e. that exchange action that was in breach of the letters of provisions of the GATT would still not be considered a “frustration” except where the conditions laid down in the Ad note were fulfilled. Logically, a “frustration” in this sense would require the prior finding of a breach of any other provision of the GATT, which – Fixitania would argue – is not possible as the exchange rate regime does not violate any GATT provisions.

- Fixitania should argue that the wording of the provision **limits its application to other GATT provisions** (“this Agreement”), i.e. that a “frustration” of provisions of other WTO Agreements would not be covered by Art. XV:4 GATT.

- Fixitania should then argue that the **exchange rate regime does not frustrate the intent** of any specific GATT provisions nor of any other WTO Agreements or provisions thereof nor of the WTO Agreements as a whole; the argument should be based on the consideration that Fixitania does not prescribe the billing practice of its ENRs, i.e. they might set their prices either in domestic currency or in foreign currencies. Economically, it is often argued that in such situation no price effects are measurable in the medium to long-term perspective as prices would react to the exchange rate (and to world market prices which are not in any way affected by Fixitania). According to that view, a fixed exchange rate has in the medium or long run no effect on import or export prices.

**d) Justification of the exchange rate regime under Art. XV:9 (a) GATT**

- Lastly, Fixitania should argue that its exchange rate policy would **benefit from justification under Art. XV:9 (a) GATT**. Insofar as one considers a frustration of the intent of any provision of any other WTO Agreement than the GATT sufficient for a violation of Art. XV:4 GATT, one would have to expand the application of Art XV:9 GATT also to those breaches.

- **Fixitania would have to prove** that the conditions of this exception or affirmative defense are met. However, this argument is difficult to make as (1) Fixitania would have to claim that the exchange rate regime is an “exchange control or exchange restriction” (which would only be convincing for the restrictions on capital exports) and (2) that it is “in accordance with the Articles of Agreement of the IMF”. Arguably, Art. XV:9 (a) GATT is limited to controls and restrictions which are subject to formal

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IMF approval. As no such approval is mentioned in the Case, Art. XV:9 (a) GATT could not apply. Fixitania could only benefit from it if it was necessary for Libertania to prove that the measures were illegal (which is not convincing given the burden of proof for exceptions under WTO law).

VI. Readings

- M. Benitah, China’s Fixed Exchange Rate for the Yuan: Could the United States Challenge it in the WTO as a Subsidy? ASIL Insight 117 (October 2003)
- M. Goldstein/N. Lardey (Eds.), Debating China’s Exchange Rate Policy, 2008
583 et seq.
- Claus D. Zimmermann, Exchange Rate Misalignment and International Law, 105 AJIL (2011) 3 (July), pp. 423 et seq.)

END OF BENCH MEMO