

ELSA MOOT COURT COMPETITION (EMC2) 2012-2013

The Case

Fixitania – Certain Measures affecting Financial Services and Influencing the Exchange-rate

Case Author: Prof. Dr. Christoph Herrmann, LL.M.

University of Passau (Germany)

1. 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.
2. 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”*.
3. 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 for 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, it is owned by the FG and it 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.

4. 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 dollars) and had lent long-term to foreign borrowers, also mainly in US dollars. 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 F 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, in the following few months, non-guaranteed banks lost many of their customers and business.
5. 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.
6. 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 reserve income at an exchange-rate for the Fixi which is being fixed against the Libertado, the currency of Libertarian, F’s 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.
7. 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. The exchange-rate for the Fixi on the FCM increased over that period of time significantly, whereas the fixed export exchange rate applicable to ENRs was held constant by the FGAt. At the end of 2011, the Fixi traded at a rate 25% higher than the fixed exchange-rate applicable to ENRs.
8. In its Staff Report, following regular consultations under Article IV of the IMF Articles of Agreement in the spring of 2012, the IMF 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 IMF 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 F’s obligations under the IMF Articles of Agreement.

9. 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.
10. 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).
11. 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:
 - a. that the REOFI breaches Article XVII of the General Agreement on Trade in Services (GATS) 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 Articles VI and XVI of the GATT, since the dual exchange-rate regime constitutes a prohibited export subsidy;
 - ii. Article XV:4 of the GATT in conjunction with the provisions of the IMF Articles of Agreement, in particular Article IV(1)(iii) thereof, since the exchange-regime constituted a manipulation of the exchange-rate of the Fixi that frustrates the intent of the GATT 1947;
12. 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 Article 13.2 of the DSU. The uniform view of all consulted experts is that the fixed exchange-rate available for ENRs is at least between 15 and 20% undervalued as compared to (hypothetical) market conditions.

Indicative references to provisions:

- General Agreement on Tariffs and Trade (GATT) 1947: Articles VI, VII:4, XI, XII, XV, XIV, XX, XXI and XXIII
- General Agreement on Trade in Services (GATS): Article XVII; Annex on Financial Services; Understanding on Commitments in Financial Services
- Agreement on Subsidies and Countervailing Measures (SCM Agreement)
- Articles of Agreement of the International Monetary Fund (IMF): Articles I and IV
- IMF Executive Board “Bilateral and Multilateral Surveillance Executive Board Decision— July 18, 2012 (IMF Public Information Notice 12/89.
- Decision Adopted by the General Council Concerning Agreements Between the WTO and the IMF and the World Bank at Its Meeting on 7, 8, and 13 November 1996 (WT/L/194, 18 November 1996)

Indicative WTO Cases:

- India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/AB/R.
- European Communities — Measures Affecting Trade in Large Civil Aircraft, WT/DS316/AB/R.
- European Communities — Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R.

Selected References on WTO (and IMF) Law:

- S. Evenett (Ed.), *The US-Sino Currency Dispute: New Insights from Economics, Politics and Law*, 2010
- C. Herrmann, Don Yuan: China’s “Selfish” Exchange Rate Policy and International Economic Law, *EYIEL* 1 (2010), pp. 31-51; available at http://www.eyiel.eu/mediapool/122/1226578/data/sample_pages_eyiel_2010.pdf
- M. Hocke, Have Measures Adopted by States to Cope With the Global Financial Crisis Been in Accordance With Their Obligations Under International Investment Law?, *Göttingen Journal of International Law, GoJIL* 4 (2012) 1, 177, available at <http://www.gojil.eu/>
- D. E. Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements, *96 AJIL* (2002), pp. 561 et seq.
- R. Staiger/A. O Sykes, “Currency Manipulation” and World Trade, *9 WTRev.* (2010), pp. 583 et seq.
- Claus D. Zimmermann, Exchange Rate Misalignment and International Law, *105 AJIL* (2011) 3 (July), pp. 423 et seq.).