ELSA MOOT COURT COMPETITION ON WTO LAW 2012-2013

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

Libertania
(Complainant)

vs

Fixitania
(Respondent)

SUBMISSION OF THE RESPONDENT
A. General

Fixitania (Respondent)

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<td>AB</td>
<td>Appellate Body</td>
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<td>AD Agreement</td>
<td>Agreement on the Implementation of Article VI GATT</td>
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<td>BIT</td>
<td>Bilateral Investment Treaty</td>
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<td>DSU</td>
<td>Dispute Settlement Understanding</td>
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<td>ENR</td>
<td>Exporter of National Relevance</td>
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<td>FCB</td>
<td>Fixitanian Central Bank</td>
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<td>FCM</td>
<td>Free Currency Market</td>
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<td>Fixitanian Stability, Economic Growth and Social Justice Act</td>
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<td>FTA</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>International Monetary Fund</td>
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<td>NAFTA</td>
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<td>REOFI</td>
<td>Regulatory Emergency Ordinance for Financial Institutions</td>
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<td>SCM Agreement</td>
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<td>VCLT</td>
<td>Vienna Convention on the Law of Treaties</td>
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**Statement of Facts**

1. Fixitania is a Member of both the WTO and IMF, as is Libertania, Fixitania’s largest trading partner. Both countries are party to the VCLT. In its Schedule of Specific Commitments, Fixitania committed itself to act in accordance with the national treatment obligation as provided for in the Understanding of Commitments in Financial Services.

2. The global financial and economic crisis has not spared Fixitania. Fixitanian commercial banks had been borrowing short-term and lending long-term on the global financial markets. This policy is used on a regular basis by commercial banks and it would not raise any problems in the ordinary course of business. However, due to the extraordinary circumstances of the crisis, the banks suffered from foreign currency shortages. In order to avoid the total drying-up of its own foreign currency reserves as a result of this shortage, the FG had to introduce restrictions on the free movement of capital.

3. Apart from these capital restrictions, additional measures were necessary, since the Fixitanian banks were on the verge of collapse. Due to the close ties between banks all over the world, a bankruptcy of the Fixitanian banks would not only have affected the Fixitanian citizens, but also banks in other states. To avoid this, the FG guarantees the savings deposited in banks registered in Fixitania and with a majority of domestic shareholders under the REOFI.

4. Meanwhile, the unemployment level shot through the roof to a record high of 20%. The GDP decreased with 15%. To tackle these local consequences of the global crisis, the FSEGSJ was adopted in 2008. This act contains measures such as supervision on financial institutions and it encourages investments. The FSEGSJ enshrines the necessary restrictions on the free movement of capital but acknowledges the importance of international trade by upholding the freedom of payments with third countries.

5. Furthermore, the FSEGSJ introduced a dual-exchange-rate regime, which preserves the general floating rate but fixes the exchange rate for certain transactions. The FCB buys all foreign currencies offered by registered ‘Exporters of National Relevance’ (ENRs) at a rate fixed against the Libertado by the FG. Other foreign transactions remain subject to the freely floating exchange rate on the FCM. The fixed exchange rate for ENRs is an essential part of the recovery package, since ENRs provide many jobs and contribute to the Fixitanian GDP. The IMF did not deem it necessary to carry out a detailed assessment in its 2012 Staff Report on whether this dual-exchange-rate regime infringes Fixitania’s obligations under the IMF Articles of Agreement.
Summary of Arguments

1 The REOFI bank guarantee is consistent with Article XVII GATS and paragraph 2 of the GATS Annex on Financial Services

- The REOFI prevented a total collapse of the financial system and Fixitania will establish that it is not inconsistent with Article XVII GATS in combination with paragraph 2 of its Annex on Financial Services.
- First, Article XVII GATS and paragraph 2 of its Annex on Financial Services prohibit Fixitania from awarding less favourable treatment to ‘like’ foreign service suppliers. The likeness test has never been clearly assessed under the GATS. The specific context of financial services calls for a specific approach that should be similar to the approach in international investment law. It should therefore include an ‘aims-and-effects’ test. Accordingly, Fixitanian banks are not ‘like’ Libertanian banks because the Fixitanian policy aim does not apply to foreign banks. Therefore, Fixitania is not in violation of Article XVII GATS by treating both types of banks differently.
- Second, even if the REOFI is inconsistent with Article XVII GATS, Fixitania can justify the measure under several exceptions to the GATS. Most importantly, the prudential carve-out exception of paragraph 2 of the Annex on Financial Services applies, as the bank guarantee is introduced for prudential reasons. Moreover, the REOFI has not been enacted in the normal course of ordinary business and confers access to a ‘lender of last resort’. Therefore, the guarantee is exempted under Section C.1 of the Understanding on Commitments in Financial Services.

2 The FSEGJSJ’s dual-exchange-rate regime is consistent with the SCM Agreement in conjunction with Articles VI and XVI GATT

- Libertania fails to prove that the dual-exchange-rate regime meets the three requirements for a prohibited export subsidy of the SCM Agreement.
- First, the dual-exchange-rate regime is not a ‘financial contribution’ or ‘any form of income or price support’. It does not fall under one of the different types of measures that can be qualified as a financial contribution found in the exhaustive list of Article 1.1(a)(1) SCM Agreement. Additionally, it does not qualify as a form of income or price support under Article 1.1(a)(2) SCM Agreement as it does not target ‘primary products’.
- Second, the dual-exchange rate regime does not provide a ‘benefit’ to ENRs as it is impossible for Libertania to carry out the required economic analysis of the effects of the
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dual-exchange rate regime. Libertania cannot suffice with a ‘benefit’ analysis for one product, such as hybrid cars, and extend these findings to all products.

- Third, the measure is not contingent upon export performance and therefore not ‘specific’. The fixed exchange rate is neither granted on the condition that ENRs raise their exports, nor does the amount of Fixi’s they get in exchange depend on their export performance. The REOFI is also not de facto contingent upon export performance.

3 The FSEGSJ is consistent with Article XV:4 GATT

- Libertania claims that the dual-exchange rate regime of the FSEGSJ frustrates the intent of the GATT 1947. It claims a violation of Article XV:4 GATT in conjunction with Article IV(1)(iii) IMF Agreement.

- Preliminary, Fixitania contests the competence of the Panel to examine whether the FSEGSJ violates the IMF Agreement in general and Article IV:1(iii) in particular.

- Article XV:4 GATT prohibits WTO Members to frustrate the intent of the provisions of the GATT by exchange action. This provision has the function of limiting the scope of other provisions of the GATT, since it requires that in addition to a violation of the letter of the text, there must also be a frustration of the intent of that provision. Only then can an exchange action be inconsistent with the GATT. Therefore, Article XV:4 GATT does not contain a legal obligation for Fixitania on which a claim in front of the WTO dispute settlement mechanism can be based.

- Even if Article XV:4 GATT would contain an obligation on which a claim can be based, this obligation does not apply in this case. First, because Article XV:4 GATT was drafted to govern the situation where a WTO Member was not yet a Member to the IMF. Libertania and Fixitania are both Member to the IMF, therefore Article XV:4 GATT does not apply to them. Second, the FSEGSJ is not an ‘exchange action’. This term only refers to exchange policies and does not cover exchange rate policies, such as the dual-exchange-rate regime of the FSEGSJ.

- Even in case Article XV:4 GATT would apply to the FSEGSJ, in conjunction with Article IV(1)(iii) IMF Agreement, it is not violated by Fixitania. First, the FSEGSJ does not constitute exchange-rate manipulation in the sense of Article IV(1)(iii) IMF Agreement and second, it does not frustrate the intent of the provisions of the GATT.

- Any inconsistency with Article XV:4 GATT can be justified under the exception contained in Article XV:9(a) GATT because the FSEGSJ is in accordance with the IMF Agreement.
Identification of the Measures at Issue

**Measure 1:** The implementation of the REOFI, which offers a bank guarantee aimed at preventing a total collapse of the Fixitanian financial sector.

**Measure 2:** The implementation of the FSEGSJ, which encourages investments in the manufacturing sector and organizes a dual-exchange-rate regime under which ENRs can exchange their foreign reserve income at a fixed exchange rate.

Legal Pleadings

**The REOFI**

1. **The REOFI bank guarantee is consistent with Article XVII GATS and paragraph 2 of the GATS Annex on Financial Services**

The Fixitanian financial institutions suffered severely from the financial and economic crisis. Like many other governments, the Fixitanian government intervened on the financial markets to avoid a detrimental ‘run on the bank’ and the resulting collapse of the Fixitanian banking sector. In order to prevent this situation, the FG committed itself in the REOFI to guarantee the savings deposited in banks registered in Fixitania and with a majority of domestic shareholders. Libertania states in its request for consultations that this bank guarantee breaches Article XVII GATS and paragraph 2 of the GATS Annex on Financial Services. Fixitania will first set out that the REOFI bank guarantee does not meet all the requirements of the three-tier test of Article XVII GATS. Second, even if the bank guarantee would violate Article XVII GATS in abstracto, it falls under the exception of ‘domestic regulation’ of paragraph 2 of the GATS Annex on Financial Services and under the exception of the Understanding on Commitments in Financial Services.

1.1 **The REOFI bank guarantee does not violate Article XVII GATS**

1.1.1 The REOFI is consistent with the national treatment obligation enshrined in Article XVII GATS. Libertania bears the burden of proof to establish a prima facie case that Fixitania has acted inconsistently with its WTO obligations. For a violation of Article XVII GATS, there has to be ‘a measure by a Member affecting trade in services’ that awards ‘like’ foreign services or service suppliers ‘less favourable treatment’ than domestic service

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1 A. Van Aaken and J. Kurtz (2009), 55-56.
suppliers. Since ‘affecting’ has to be interpreted broadly, Fixitania concedes that the REOFI is a governmental measure which could have an effect on the trade in financial services. However, it will be established below that foreign-owned banks established in Fixitania are not ‘like’ Fixitanian domestic banks. Therefore, the obligation to grant no less favourable does not extend to subsidiaries of foreign banks.

1.1.2 The second aspect of the national treatment-test of Article XVII GATS requires that the domestic and foreign services or service suppliers are ‘like’. The meaning of likeness under the GATS has never been clearly assessed. The likeness-test developed in GATT-cases examines whether products share the same characteristics, consumer preferences and end-uses and tariff classification. However, due to the characteristics and complexity of ‘services’ and ‘service suppliers’, a mere transposition of this broad approach from the GATT to the GATS is not suitable. The services sector in general and financial services in particular is too sensitive for such a broad concept of ‘likeness’. The drafters of the GATS intended to leave more regulatory freedom to WTO Members in this area. Therefore, Fixitania submits that the notion of ‘likeness’ should be construed narrowly. In fact, the aim and effect of the REOFI bank guarantee should be taken into account. This approach fills the gap that currently exists in the likeness-test under the GATS for financial services.

1.1.3 Inspiration for this approach to services can be found in international investment law. Several free trade agreements (FTAs) and bilateral investment treaties (BITs) include a clause on national treatment similar to Article XVII GATS. The national treatment obligation of these clauses is also restricted by a likeness-test. Although FTAs and BITs use the term ‘like circumstances’ instead of ‘like services and like service suppliers’, the ‘aims-and-effects’ reasoning of these agreements can be transposed to the GATS.

1.1.4 A prominent example can be found in the North-American Free Trade Agreement (NAFTA). The NAFTA Tribunal decided in S.D. Myers Inc. v. Canada that the assessment of

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3 EC – Bananas III (AB Report), par. 20.
4 EC – Bananas III (Panel Report), par. 7.322; US – Gambling (Panel Report), Section III.B.5(a); Canada – Autos (Panel Report), paras. 10.283-10.289; N. DIEBOLD (2010), 104 and 120.
6 M. COSSY (2006), 46.
7 W. ZDOUC (1999), 341-342.
9 OECD (2012), 7; A. LANG (2204), 830.
10 R. DOLZER and C. SCHREUER (2008), 179.
‘like circumstances’ should include reasonable policy grounds.\textsuperscript{11} In \textit{GAMI v. Mexico}, the Tribunal accepted the solvency of a local sugar industry as a legitimate policy goal.\textsuperscript{12}

1.1.5 Similar to the GATS, ‘likeness’ is very vague under NAFTA, and therefore policy aims are taken into account. The policy aim of ensuring financial and economic stability is vital for Fixitania. Therefore, Fixitania is convinced that a reasoning similar to that applied by the NAFTA-Tribunal is necessary. After all, the aim of the REOFI bank guarantee is ensuring financial stability and limiting public debt. According to this double policy aim, Fixitanian domestic banks and subsidiaries of foreign banks are not ‘like’. The bank guarantee is an absolute necessity for the Fixitanian banks, whereas this is not necessary for foreign banks. If one of Fixitania’s major domestic banks goes bankrupt, this would cause a chain-reaction in Fixitania’s economy threatening the solvency of other Fixitanian banks. Foreign subsidiaries, by contrast, can fall back on their parent companies abroad when experiencing liquidity or solvency problems. This is an inherent difference. Therefore the Fixitanian banks and foreign banks are not like service suppliers.

1.2 The REOFI bank guarantee can be justified by the prudential carve-out exception

1.2.1 Should the REOFI bank guarantee be found inconsistent with Article XVII GATS, this inconsistency can be justified by the prudential carve-out exception enshrined in paragraph 2(a) of the GATS Annex on Financial Services. That paragraph provides that WTO Members shall not be prevented by the GATS from taking measures for prudential reasons. The prudential reasons allowed include the protection of depositors, as well as ensuring the integrity and stability of the domestic financial system. This may include measures to prevent a banking sector from collapse.\textsuperscript{13} The bank guarantee laid down in the REOFI aims to attain both of these prudential goals listed in paragraph 2(a). By guaranteeing the savings of depositors, the FG prevents a run on the bank and the resulting major liquidity problems of the banks. By not extending the guarantee to all banks worldwide, the FG prevents an explosion of Fixitania’s public debt. Consequently, the bank guarantee protects depositors and ensures the integrity and stability of Fixitania’s financial system.

1.2.2 Fixitania acknowledges that the exception of paragraph 2 of the GATS Annex on Financial Services is not unconditional. Paragraph 2(a) \textit{in fine} states that measures that \textit{prima facie} fall under the exception cannot be used to avoid the Member’s commitments or


\textsuperscript{12} \textit{GAMI Investments Inc. v. United Mexican States}, Final Award, 15 November 2004, par. 114.

\textsuperscript{13} A. Van Aaken and J. Kurtz (2009), 59.
obligations under the GATS. The REOFI bank guarantee, however, cannot be considered to be such an evasive measure.

1.2.3 The wording of the last sentence of paragraph 2(a) is quite vague and warrants an interpretation analogous to that of other GATT and GATS exceptions.\textsuperscript{14} The exceptions of Article XX GATT and Article XIV GATS, for instance, fully apply if the measure is less trade-restrictive than alternative measures. In order to qualify as a less trade-restrictive measure in a specific case, the measure has to be as effective in reaching the goal of the contested measure while having a less negative impact on the WTO obligation.\textsuperscript{15}

1.2.4 The aim of the REOFI bank guarantee is to protect depositors and to limit public debt. It is very similar in effect to prudential measures taken by states such as Australia, Ireland, Germany and Switzerland to counter the financial crisis.\textsuperscript{16} None of these measures have been challenged in front of the WTO. By guaranteeing the savings accounts and focusing on the banks that are most threatening for the financial stability, the REOFI reconciles both legitimate policy aims. The most plausible alternative to the REOFI bank guarantee would be a general guarantee for all saving accounts in Fixitania, for both domestic banks and subsidiaries of foreign banks. This alternative measure, however, would not be as efficient in reaching the double aim. Although it would also protect depositors, the burden of potential bailouts on the Fixitanian government would be unbearable. Such a measure would risk replacing a financial crisis with a sovereign-debt crisis and is thus not efficient in reaching the essential goal of stability. Furthermore, a general guarantee would not only cause an internal shift of the problem within Fixitania, but would also have an external negative spill-over effect. Depositors of other states where no such guarantee is provided, would massively transfer their money to ‘the safe haven’ Fixitania. This might result in a collapse of foreign banking sectors.

1.2.5 Therefore, the FG has opted for the least trade-restrictive measure by passing the REOFI bank guarantee. The alleged negative effects of the measure on foreign subsidiaries are unavoidable and far less severe than the effects of a general guarantee. In conclusion, the REOFI bank guarantee falls within the scope of the exception of paragraph 2 of the Annex on Financial Services and is accordingly not inconsistent with Fixitania’s WTO obligations.

\textsuperscript{14} B. DE MEESTER (2010), 757; E. LEROUX (2002), 430-431.

\textsuperscript{15} China – Audiovisuals (AB Report), par. 318; US – Tuna/Dolphin II (GATT Panel Report), par. 5.35; Thailand – Cigarettes (GATT Panel Report), par. 75.

\textsuperscript{16} A. VAN AAKEN and J. KURTZ (2009), 55-56.
1.3 The REOFI bank guarantee can benefit from the exceptions of the Understanding

1.3.1 Even if the prudential carve-out exception would not apply, Fixitania can justify the REOFI under the Understanding, which specifies the obligations under the GATS. Section C.1 of the Understanding specifies the national treatment obligation in the financial services sector. It indicates that the obligation to grant access to official funding and refinancing facilities to foreign financial service suppliers established in its territory only applies “in the normal course of ordinary business”. Since the financial crisis is an emergency situation and the REOFI is an emergency measure, not taken in the normal course of ordinary business, the REOFI can benefit from this exception to the national treatment obligation.17

1.3.2 Secondly, the last sentence of Section C.1 of the Understanding states that “this paragraph is not intended to confer access to the Member's lender of last resort facilities”. In the REOFI, the FG committed itself to guarantee the savings accounts deposited at the Fixitanian banks. If one of these banks goes bankrupt, the FG must carry out the guarantees under the REOFI by using its own funds or the monetary reserves of the FCB. Therefore, the REOFI confers access to a ‘lender of last resort’. According to the Understanding, the national treatment obligation of the GATS, as it is specified in that Understanding, is not intended to confer access to a lender of last resort. Therefore, Fixitania is not obligated to extend the REOFI to foreign banks established in its territory.

1.3.3 Since Fixitania can justify a possible violation of the national treatment obligation of the GATS by the REOFI under the prudential carve-out exception and the Understanding on Commitments in Financial Services, Fixitania has acted consistently with its obligations under the GATS.

The FSEGSJ

In addition to the financial sector, other parts of the Fixitanian economy were also severely hit by the crisis. Fixitania’s GDP decreased with 15% within one year and unemployment rose to a 20% record high. To address this downward spiral, Fixitania introduced a dual-exchange-rate regime in the FSEGSJ, providing ENRs with a stable exchange rate in times of high volatility. The Permanent Court of International Justice held in 1929 that a State’s power to regulate its own currency is a well-established and generally accepted principle of public

17 A. VON BOGDANDY and J. WINDSOR (2008), 662-663.
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international law.\textsuperscript{18} Fixitania will rebut the two claims made by Libertania and will establish that it adheres to its WTO obligations. First, Libertania claims that this dual-exchange-rate regime constitutes a prohibited ‘export subsidy’ that violates the SCM Agreement in conjunction with Articles VI and XVI GATT. Secondly, Libertania argues that the dual-exchange-rate regime infringes Article XV:4 GATT in conjunction with Article IV:1(iii) IMF Agreement, because it frustrates the intent of the GATT 1947.

2 The FSEGSJ’s dual-exchange-rate regime is consistent with the SCM Agreement in conjunction with Articles VI and XVI GATT

The dual-exchange-rate regime introduced by the FSEGSJ does not constitute a prohibited export subsidy under the SCM Agreement, read in conjunction with Articles VI and XVI GATT. The dual-exchange-rate regime does not meet the three requirements of a prohibited export subsidy. First, it cannot be qualified as a ‘financial contribution’ or ‘any form of income or price support’. Second, the measure does not provide a ‘benefit’ to ENRs. Third, the measure is not de jure or de facto contingent upon export performance and is therefore not ‘specific’.

2.1 The FSEGSJ’s dual-exchange-rate regime is neither a ‘financial contribution’, nor ‘any form of income or price support’

The dual-exchange-rate regime does not meet the first requirement of the definition of ‘subsidy’ in Article 1 SCM Agreement. The measure can neither be qualified as a ‘financial contribution by a government or any public body’, nor does it fall under ‘any form of income or price support in the sense of Article XVI of GATT 1994’. As recently stated by the Panel in China – GOES, both concepts should be interpreted narrowly.\textsuperscript{19}

(i) The FSEGSJ is not a ‘financial contribution by a government or any public body’

2.1.1 The dual-exchange-rate regime cannot be qualified as a ‘financial contribution by a government or any public body’. Article 1.1(a)(1) SCM Agreement provides an exhaustive list of different types of measures that can be qualified as a financial contribution.\textsuperscript{20} The dual-exchange-rate regime does not fall within the scope of any of these categories.

2.1.2 First, the FSEGSJ does not provide for a direct transfer of funds or a potential direct transfer of funds as described in Article 1.1(a)(1)(i) SCM Agreement. The fact that ENRs

\textsuperscript{18} PCIJ 12 July 1929, Case Concerning the Payment of Various Serbian Loans Issued in France, Series A, No. 20/1, p. 44; PCIJ 12 July 1929, Case Concerning Payment in Gold of Brazilians Federal Loans Contracted in France, Series 1, No. 21/1, p. 122.

\textsuperscript{19} China – GOES (Panel Report), paras. 7.79-7.93.

\textsuperscript{20} P. VAN DEN BOSSCHE (2008), 562; C.D. ZIMMERMANN (2011), 447.
receive more Fixi’s for their foreign currencies than they would receive under the freely floating rate, does not alter this finding. An interpretation of this fact as a ‘direct transfer of funds’ would amount to a mix-up of the concepts of ‘financial contribution’ and ‘benefit’, as stated in US – Export Restraints.\textsuperscript{21} The Panel stressed that the drafters of the SCM Agreement foreclosed the possibility of the treatment of any government action that resulted in a benefit as a subsidy. They effectively narrowed the definition of a subsidy by adding the notion of ‘financial contribution’.\textsuperscript{22} Therefore, an analysis of the effects of the dual-exchange-rate regime can only serve the purpose of proving the ‘benefit’ requirement and not of the ‘financial contribution’ requirement. However, this does not mean that such a benefit is present in this case (infra 2.2).

\textbf{2.1.3} Second, the fixed rate for ENRs cannot be considered as ‘government revenue, otherwise due, that is foregone or not collected’ as required by Article 1.1(a)(1)(ii) SCM Agreement. The Panel in US – FSC stated that the ‘otherwise due’ refers to the situation that would prevail \textit{but for} the measure at issue.\textsuperscript{23} Due to the economic complexity of transactions subject to exchange rates, it cannot be shown that the FG would have collected more revenue in the absence of the dual-exchange-rate regime.

\textbf{2.1.4} Third, the dual-exchange-rate regime does not fall within the scope of ‘the provision by a government of goods or services other than general infrastructure’ in the sense of Article 1.1(a)(1)(iii) SCM Agreement. As ZIMMERMANN remarks, an inclusive interpretation would go well beyond the intended scope of Article 1 SCM Agreement.\textsuperscript{24} In a broad interpretation, any exchange rate regime other than a freely-floating rate and any measure to protect the economy from harmful shifts in the exchange rate may be qualified as a governmental service.\textsuperscript{25} Reducing the exchange rate risk faced by exporters does not amount to a service provided by the government that can be targeted by the SCM Agreement.\textsuperscript{26}

\textbf{2.1.5} Finally, the dual-exchange-rate regime is not a financial contribution from the government through one or more private entities or funding mechanism under Article 1.1(a)(1)(iv) SCM Agreement. The FSEGSJ is carried out by the FCB which is a governmental body since it is owned by the FG and is under the direct authority of the Fixitanian Minister of Finance. Therefore, the dual-exchange rate regime does not qualify as a financial contribution under Article 1.1(a)(1) SCM Agreement.

\textsuperscript{21} C.D. ZIMMERMANN (2011), 448.
\textsuperscript{22} US – Export Restraints (Panel Report), par. 8.38.
\textsuperscript{23} Panel Report, US – FSC, par. 7.45.
\textsuperscript{24} C.D. ZIMMERMANN (2011), 448.
\textsuperscript{25} \textit{Ibid.}
\textsuperscript{26} \textit{Ibid.;} A. DE LIMA-CAMPOS and J.A. GAVIRIA (2012), 1026.
(ii) The FSEGSJ is not a ‘form of income or price support’

2.1.6 The dual-exchange-rate regime does not amount to ‘any form of income or price support in the sense of Article XVI GATT’ as meant in Article 1.1(a)(2) SCM Agreement. The exact meaning of this term has not yet been clarified through WTO dispute settlement. However, Article 1.1(a)(2) SCM Agreement refers explicitly to Article XVI GATT. Therefore, the term should be limited to measures affecting ‘primary products’, such as minimum prices in the agricultural sector. Both the ordinary meaning of ‘income or price support’ and the Interpretative Note 2 Ad Paragraph 2 of Article XVI GATT point in this direction. The fixed rate for ENRs is not targeted at, nor limited to, primary products. The dual-exchange-rate regime can thus not be qualified as a form of income or price support. Moreover, according to the Panel in China – GOES, the term ‘price support’ does not include all government intervention that may have an effect on prices.

2.2 The FSEGSJ is not a subsidy as it does not confer a ‘benefit’

2.2.1 Furthermore, the dual-exchange-rate regime cannot be considered to confer a ‘benefit’ in the sense of Article 1.1(b) SCM Agreement. First of all, the classic market comparison test cannot be carried out for the dual-exchange-rate regime. Second, the claim that Article VI GATT has been infringed, is unwarranted. Third, Libertania fails to prove that a benefit has been conferred for every single product.

2.2.2 First, according to the Appellate Body in Canada – Aircraft, it is necessary to determine “whether the recipient has received a financial contribution on terms more favourable than those available to the recipient in the market” (emphasis added). This involves a comparison with the ‘marketplace’. There is no marketplace to compare with in the realm of exchange rates. As stated above, the Permanent Court of International Justice recognizes the principle of monetary sovereignty, which also underpins the IMF Articles of Agreement. Both the freely-floating exchange rate and the fixed rate are emanations of Fixitania’s monetary sovereignty. Although the freely-floating rate is ‘market-based’, it depends just as much on Fixitania’s sovereignty as any other exchange rate regime. It is therefore impossible to carry out the benefit-analysis under Article 1.1(b) SCM Agreement.

2.2.3 Second, even when such an analysis could be carried out, it is impossible to invoke Article VI GATT to establish a ‘benefit’. By claiming the infringement of Article VI GATT in conjunction with Article XVI GATT and the SCM Agreement, Libertania does not respect

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27 Analytical Index of the GATT, 445.
28 China – GOES (Panel Report), par. 7.85.
29 Canada – Aircraft (AB Report), par. 157.
30 Ibid.
the difference between these Articles. The AD Agreement aims at products and companies, not at measures taken by governments for macroeconomic policy reasons, such as the FSEGSJ.\textsuperscript{31} Article VI GATT and the AD Agreement are thus not applicable. The calculation of a dumping-margin of Article VI GATT can therefore not be used to determine a ‘benefit’ in the sense of Article XVI GATT. It can be derived from case law that Article VI GATT and Article XVI GATT cannot be read together since there exists no legal basis to read Article VI GATT in conjunction with the provisions of the SCM Agreement. The Panel in \textit{US – Fresh, Chilled and Frozen Pork} stressed that “the purposes of Article VI and Article XVI [are] fundamentally different”.\textsuperscript{32} A similar reasoning can also be found in \textit{US – Wine and Grapes}.\textsuperscript{33} This reasoning applies \textit{a fortiori} to the SCM Agreement as it does not refer to Article VI GATT concerning the benefit requirement in Article 1.1(b) SCM Agreement.

\textbf{2.2.4} Third, even if it would be possible to carry out an examination of the ‘benefit’ under Article 1.1(b) SCM Agreement, Libertania has to prove that this ‘benefit’ has been granted for each product that the ENRs export to Fixitania. Libertania cannot suffice with a ‘benefit’ analysis for one product, such as hybrid cars, and extend these findings to all products. The analysis has to take into account a range of factors which differ according to the product and the industry sector. There are insufficient facts that would enable such an analysis.

\textbf{2.3} \textbf{The dual-exchange-rate regime is not de facto or de jure ‘export contingent’}

\textbf{2.3.1} It has now been established that the dual-exchange-rate regime does not meet the two requirements of Article 1.1(a) and (b) in order to qualify as a subsidy. Fixitania will now also establish that the FSEGSJ does not meet the third requirement of ‘specificity’. Libertania argues that the dual-exchange-rate regime constitutes a prohibited export subsidy. Although export subsidies are presumed to be ‘specific’, in order to benefit from this presumption Libertania has to prove that the dual-exchange-rate regime can be qualified as an ‘export subsidy’. According to Article 3.1(a) SCM Agreement, an export subsidy has to be “contingent, in law or in fact, upon export performance”. The fixed exchange rate is neither granted to ENRs \textit{on the condition that} they are able to raise their exports, nor does the amount of Fixi’s they get in exchange \textit{depend on} their export performance. Therefore, the dual-exchange-rate regime is not \textit{de jure} contingent upon export performance.

\textbf{2.3.2} Nevertheless, Libertania could still try to prove that there is \textit{de facto} contingency. According to the AB in \textit{Canada – Aircraft}, three elements must be present in order to

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\textsuperscript{32} \textit{US – Fresh, Chilled and Frozen Pork} (GATT Panel Report), par. 4.6.

\textsuperscript{33} \textit{US – Wine and Grapes} (GATT Panel Report), par. 4.5.
establish *de facto* contingency within the meaning of footnote 4 of the SCM Agreement: (i) the granting of a subsidy (ii) tied to (iii) actual or anticipated exportation or export earnings. Libertania fails to prove that the fixed exchange rate for ENRs is *de facto* contingent upon export performance, as will be demonstrated below.

**2.3.3** It has already been established that the dual-exchange-rate regime does not constitute a subsidy. Furthermore, even if it would be considered a subsidy it is not ‘tied to actual or anticipated exportation earnings’. It follows from WTO case law that this involves a complex analysis of a range of factors. Libertania bears the full burden of proof to establish *de facto* contingency for each and every product that allegedly benefits from the Fixitanian fixed rate for ENRs. Similarly to the ‘benefit’ requirement, it cannot suffice to prove the *de facto* contingency for one product and extend this to all products from ENRs that are imported into Libertania. Moreover, the dual-exchange-rate regime is not anticipated on exportation earnings, since the aim was to ascertain ENRs would survive the economic crisis by providing them with a stable exchange rate. Even if Fixitania could have foreseen that export would result, this is not enough to prove ‘anticipated exports’.

**3 The FSEGSJ is consistent with Article XV:4 GATT**

Libertania claims that the dual-exchange-rate regime of the FSEGSJ frustrates the intent of the GATT and is therefore inconsistent with Article XV:4 GATT. This article also prohibits the frustration of the intent of the IMF Agreement by trade action. Since Libertania only claims that the intent of the GATT has been frustrated, Fixitania will not elaborate on the hypothesis that the FSEGSJ is a trade action, as the jurisdiction of the Panel is limited to the terms of reference, based on the claims set out by Libertania.

Preliminary, Fixitania challenges the jurisdiction of the Panel to interpret the IMF Agreement in general, and Article IV:1(iii) in particular. The Panel is not in a position to conclude that the IMF Agreement has been violated by Fixitania. Secondly, Article XV:4 GATT does not contain a legal obligation for Fixitania. It merely limits the scopes of other provisions of the GATT. Even if it would contain an obligation, this obligation does not apply because both Libertania and Fixitania are IMF Members. Moreover, the FSEGSJ is not an ‘exchange action’ in the sense of Article XV:4. If Article XV:4 would apply, it is not violated because

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34 *Canada – Aircraft* (Panel Report), par. 7.648; *Canada – Aircraft* (AB Report), par. 171.
36 *Canada – Aircraft* (AB Report), par. 172.
37 Article 6.2 and 7.1 DSU; J. PAUWELYN (2003), 459.
the FSEGSJ does not by exchange action frustrate the intent of the GATT. And even if the FSEGSJ would violate Article XV:4 GATT, it is justified by the exception contained in Article XV:9(a) GATT.

3.1 The Panel does not have jurisdiction to interpret the IMF Agreement

3.1.1 Libertania asserts that Article XV:4 GATT should be read in conjunction with the IMF Agreement, in particular Article IV:1(iii) thereof. A WTO Panel, however, does not have jurisdiction to interpret the IMF Agreement. According to Article 3.2 DSU, WTO Panels have the power to clarify the provisions of any of the “covered agreements”, which do not include the IMF Agreement. Interpreting the IMF Agreement would not only impede on the jurisdiction of the IMF, it would also endanger the legitimacy of the WTO.38

3.1.2 This jurisdictional problem was foreseen by the drafters of the GATT 1947 and the solution to it can be found in Article XV:2 GATT. According to this article, the Panel has the duty to “consult fully” with the IMF in cases concerning foreign exchange arrangements such as the one at issue in this case. Also in accordance with Article XV:2 GATT, the Panel “shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund.” For legal matters related to the IMF Agreement, the WTO should therefore consult with the IMF and accept its determination of those legal issues.39 This is supported by paragraph 8 of the WTO-IMF Cooperation Agreement, which states that “The Fund shall inform in writing the relevant WTO body (including dispute settlement panels) considering exchange measures within the Fund’s jurisdiction whether such measures are consistent with the Articles of Agreement of the Fund.”40 Article XV:2 GATT in conjunction with paragraph 8 of the WTO-IMF Cooperation Agreement implies that the IMF determines whether an exchange rate regime is in accordance with the IMF Agreement and the WTO must accept this legal finding.

3.1.3 Even though the IMF experts determined that the exchange rate for ENRs was undervalued, the IMF did not assess whether Fixitania was in breach of any of its obligations under the IMF Agreement.41 The Panel should conclude from this non-assessment by the IMF that Fixitania acted consistently with Article IV:1(iii) IMF Agreement. Should the Panel question this, it should request a formal determination from the IMF on the basis of Article

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39 Dominican Republic – Cigarettes (Panel Report), par. 7.138; Argentina – Textiles (AB Report), par. 84.
40 Agreement between the International Monetary Fund and the World Trade Organization, par. 8.
41 Fixitania – Certain Measures affecting Financial Services and Influencing the Exchange-rate, par. 8.
B. Substantive

XV:2 GATT. Only the IMF can find a violation of Article IV:1(iii) IMF Agreement. Consequently, the Panel should strike down the claim as far it concerns the interpretation of the IMF Agreement, in particular with regard to the alleged violation of Article IV:1(iii).

3.2 Article XV:4 GATT does not contain a legal obligation for Fixitania

3.2.1 Article XV:4 GATT does not contain a legal obligation for Fixitania and can therefore not be the basis of a claim before the Panel. According to Article XV:4, WTO Members “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.” Although the vague wording of Article XV:4 might – at first glance – be interpreted as imposing an obligation on WTO Members, this is an incorrect interpretation.

3.1.2 The *Ad* Note to Article XV GATT makes it clear that Article XV:4 GATT was not intended as an independent legal basis for a claim. On the contrary, it introduces an additional condition that has to be fulfilled in order to establish that an ‘exchange action’ violates one or more of the GATT provisions. According to the *Ad* Note, the term frustrate “is intended to indicate […] that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article.” This means that an exchange action can only be inconsistent with a GATT provision when there is also an appreciable departure from the intent of that provision. The *Ad* Note gives examples of exchange actions that, although they might infringe the *letter* of a GATT provision, do not infringe the *intent* of that provision. An exchange action is only inconsistent with the GATT if the intent of a GATT provision is frustrated, in addition to the ‘literal’ or ‘technical’ infringement of that provision.

3.1.3 In sum, Article XV:4 GATT is in fact not intended as a provision on which an independent claim can be based before the WTO dispute settlement body. Quite the opposite, according to its *Ad* Note, it is a provision that reduces the coverage of other provisions of the GATT. Therefore, it does not contain a legal obligation for Fixitania.

3.3 Article XV:4 GATT does not apply in this case

3.3.1 Even if Article XV:4 GATT contains a separate legal obligation, it does not apply in this case. First, Article XV:4 does not apply because both Libertania and Fixitania are IMF Members. This provision was drafted to regulate the situation where a Member of the GATT 1947 was not yet a Member of the IMF. Article XV:6 requires WTO Members to comply with IMF obligations or to enter into a special exchange arrangement with the Contracting

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43 J. JACKSON (1969), 482.
Parties. Article XV:7(a) GATT explains the reason for this requirement, being “that the objectives of this Agreement will not be frustrated as a result of action in exchange matters”. Article XV:7(a) implies that membership to the IMF is a sufficient warranty that the objectives of the GATT will not be frustrated by exchange action. Therefore, Article XV:4 was only meant to be applicable in the period of time before accession to the IMF or the special exchange arrangement.\textsuperscript{44} Since Fixitania and Libertania are both Members of the WTO and the IMF, Article XV:4 GATT does not apply in this case.

3.3.2 Second, the FSEGSJ’s dual-exchange-rate regime is not an ‘exchange action’. The term ‘exchange action’ has never been defined by the WTO and its ordinary meaning does not clarify whether exchange rate policies would be covered by it.\textsuperscript{45} According to Article 3.2 DSU, a Panel must clarify the term ‘exchange action’ “in accordance with customary rules of interpretation of public international law”. Since the VCLT is a codification of customary international law, its interpretative methodology must be applied.\textsuperscript{46} Article 31(3)(c) VCLT requires that the Panel shall take into account “any relevant rules of international law applicable in the relations between the parties”. The AB has used international treaties with a different membership than the WTO to interpret the ordinary meaning of a term in the covered agreements.\textsuperscript{47} Therefore, the Panel must take into account the IMF Agreement, to which both Fixitania and Libertania are a party, when interpreting the term ‘exchange action’.

3.3.3 The IMF Agreement makes a clear distinction between ‘exchange policies’ and ‘exchange rate policies’. While the former concern the convertibility of currency, the latter concern the relative value of currencies.\textsuperscript{48} The term ‘exchange action’ under Article XV:4 GATT only captures ‘exchange policies’. This interpretation is supported by the drafting history of Article XV:4 GATT. At the time the GATT 1947 was being negotiated, any change to the relative value of currency required ex-ante approval of the IMF. Therefore, the GATT did not need to contain a provision against the harmful trade effects of exchange rate manipulation.\textsuperscript{49} The drafters were only concerned with ‘exchange policies’. This conclusion is also supported by other sections of Article XV GATT. Article XV:1 emphasizes ‘quantitative restrictions’, which correlate with the IMF’s ‘exchange restrictions’. Similarly,

\textsuperscript{44} C. D. ZIMMERMANN (2011), 470.
\textsuperscript{45} J. MIRANDA, “Currency undervaluation as a violation of GATT Article XV(4)” in S. EVENETT (2010), 119.
\textsuperscript{46} EC – Computer Equipment (AB Report), par. 86; Canada – Dairy (AB Report), par. 138; US – Gasoline (AB Report), par. 16; Japan – Alcoholic Beverages II (AB Report), par. 104.
\textsuperscript{47} US – Shrimp (AB Report), par. 132.
\textsuperscript{48} E. DENTERS (2003), par. 118; A. VITERBO (2012), 152 and 289.
\textsuperscript{49} A. VITERBO (2012), 310; C. HERMANN (2010), 47; C. KOOPS (2010), 1; M. WAIBEL, “Retaliating against exchange-rate manipulation under WTO rules” in S. EVENETT (2010), 135.
Article XV:9 GATT, which forms an exception to Article XV:4, deals with ‘exchange restrictions’ and ‘exchange controls’. These terms do not cover ‘exchange rate policies’.\(^{50}\)

3.3.4 Article XV:4 refers to ‘exchange action’ and not to ‘exchange rate action’. It only captures convertibility and liberalization of payments, not exchange rate policies.\(^{51}\) It is clear from the facts of the case that although the FSEGSJ introduces a dual-exchange-rate regime, it upholds the freedom of payments.\(^{52}\) The FSEGSJ consequently does not fall under the term ‘exchange action’ of Article XV:4 GATT. Therefore, Article XV:4 does not apply.

3.4 Fixitania has acted consistently with Article XV:4 GATT

3.4.1 Should Article XV:4 GATT nevertheless be considered applicable, then Fixitania has still acted consistent with this provision. In order to establish that Fixitania violated Article XV:4 GATT in conjunction with Article IV:1(iii) of the IMF Agreement by means of an exchange action, Libertania has to prove two points: (i) that Fixitania violates Article IV:1(iii) IMF Agreement, and (ii) that Fixitania thereby frustrates the intent of a provision of the GATT.\(^{53}\) As Fixitania will show in the following paragraphs, Libertania cannot prove any of these two points.

(i) The FSEGSJ is consistent with Article IV:1(iii) of the IMF Agreement

3.4.2 Fixitania refers to its preliminary argument made in paragraph 3.1 in which it contests the jurisdiction of the Panel to interpret the IMF Agreement in general and Article IV:1(iii) of that agreement in particular.

3.4.3 Assuming, arguendo, that the Panel has jurisdiction to interpret the Articles of Agreement of the IMF, it cannot be established that Fixitania’s dual-exchange-rate regime violates Article IV:1(iii) IMF Agreement. This article provides that IMF 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.” This provision is clarified in a 2012 IMF Executive Board Decision. The words ‘in order to’ indicate that exchange rate manipulation is only contrary to Article IV:1(iii) IMF Agreement if the Member manipulates its currency with a specific intention.\(^{54}\) Therefore, Libertania bears the burden of proof of establishing both a ‘manipulation’ of the exchange rate and the existence of a forbidden ‘intent’.

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\(^{50}\) A. VITERBO (2012), 152.


\(^{52}\) Fixitania – Certain Measures affecting Financial Services and Influencing the Exchange-rate, paras. 5 and 6.


\(^{54}\) IMF Executive Board Decision (2012), Annex, par. 2.
3.4.4 Fixitania acknowledges that the FG holds the exchange rate for ENRs constant. However, exchange rate manipulation is only prohibited under Article IV:1(iii) if it is done with the intent to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over another Member. According to the 2012 Decision, this requires a Member to be engaged in exchange rate policies (i) “for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate” (ii) “and the purpose of securing such misalignment is to increase net exports”. The burden of proof is on the Complainant and the Respondent is “given the benefit of any reasonable doubt” with respect to the representation of its intentions.

3.4.5 The intent of the FSEGSJ is to aid the Fixitanian economy in its recovery from the global financial and economic crisis. Due to the crisis, unemployment reached a record high of 20% and Fixitania’s GDP fell by 15%. ENRs contribute significantly to Fixitania’s GDP. Providing them with a stable exchange rate is essential for the viability of Fixitania’s economy. Libertania cannot prove beyond any reasonable doubt that this is not the paramount intent of the FSEGSJ. Therefore, Article IV:1(iii) IMF Agreement is not violated.

(ii) The FSEGSJ does not frustrate the intent of the provisions of the GATT

3.4.6 The dual-exchange-rate regime installed by the FSEGSJ does not frustrate the intent of the GATT. First, the general intent of the GATT will be established. Secondly, Fixitania will show that this intent has not been frustrated by the FSEGSJ.

3.4.7 Prima facie, the intent of the GATT could be understood as “liberalizing trade through the reduction and removal of barriers to trade”. This is, however, an incomplete interpretation of the intent of the GATT 1947. In its Preamble, “raising standards of living” and “ensuring full employment” are also listed among the essential aims of the GATT.

3.4.8 The aim of the fixed exchange rate for ENRs is to help the Fixitanian economy recover. It is intended to end the downward economic spiral of a dramatically shrinking GDP and rising unemployment. This policy contributes to the intent of the GATT as it provides for a stable exchange rate for ENRs. The FG has always kept the fixed rate at the same level in order to create predictability, which enables ENRs to work with stable prices and output levels. It prevents ENRs from being subject to high exchange rate volatility in times of crisis, thereby enhancing employment and standards of living. Therefore, it does not frustrate the intent of the GATT. Consequently, there is no violation of Article XV:4 GATT.

55 Ibid.
56 Ibid, par. 3.
57 B. MERCURIO and C. S. N. LEUNG (2009), 1288.
3.5 Even if the FSEGSJ is inconsistent with Article XV:4 GATT, this inconsistency can be justified by the exception contained in Article XV:9(a) GATT

3.5.1 Article XV:9(a) GATT provides that nothing in the GATT shall preclude “the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund”. Article XV:9(a) takes precedence over Article XV:4 because it is more specific. It creates a general exception to the GATT. The GATT negotiating history supports this interpretation. The object and purpose of Article XV:9(a) GATT require it to be applicable to all exchange rate related policies of WTO Members that are consistent with the IMF Agreement. A contrary interpretation would give rise to contrary rights and obligations under the GATT and the IMF Agreement. An exchange rate measure that is consistent with the IMF Agreement might otherwise still be challenged under WTO law.

3.5.2 It has been established above that the FSEGSJ is not inconsistent with Article IV:1(iii) IMF Agreement. Consequently, it can be justified under Article XV:9 GATT.

3.6 In conclusion: Fixitania’s measure is consistent with Article XV:4 GATT

Fixitania has first demonstrated that Article XV:4 GATT does not contain a legal obligation. On the contrary, according to its Ad Note, it introduces an additional condition to establish a violation of other GATT provisions by exchange arrangements. Secondly, even if it does contain a legal obligation, Article XV:4 is not applicable because it was not drafted for the situation where both parties are IMF Members, which is the case here. Moreover, the dual-exchange-rate cannot be qualified as an ‘exchange action’. Thirdly, if Article XV:4 would apply, it has not been violated by Fixitania. The dual-exchange-rate does not fulfill the ‘manipulation’ or the ‘intent’ requirement of Article IV:1(iii) IMF Agreement. Furthermore, it does not frustrate the intent of the provisions of the GATT. Finally, should the Panel hold that Article XV:4 GATT has been violated, this violation can be justified by the exception contained in Article XV:9(a) GATT. Because of all these reasons, the FSEGSJ is consistent with Fixitania’s obligations under the GATT.

58 A. VITERBO (2012), 308-309.
59 Ibid., 206 and 309.
60 D. SIEGEL (2002), 609; C. KOOPS (2010), 12.
**Request for Findings**

For the above stated reasons, Fixitania respectfully requests the Panel to:

(i) Find that the REOFI is consistent with the obligations contained in Article XVII GATS and Paragraph 2 of its Annex on Financial Services;

(ii) Find that the FSEGSJ does not constitute a prohibited export subsidy, and as such is consistent with the SCM Agreement in conjunction with Articles VI and XVI GATT;

(iii) Find that the FGEGSJ is consistent with Art. XV:4 GATT in conjunction with the provisions of the IMF Articles of Agreement.