Team: [054]

ELSA MOOT COURT COMPETITION ON WTO LAW 2012-2013

Fixitania – Certain Measures affecting Financial Services and Influencing the Exchange-rate (Respondent: Fixitania)

Libertania

(*Complainant*)

VS

Fixitania

(*Respondent*)

SUBMISSION OF THE RESPONDENT

Albania • Armenia • Austria • Azerbaijan • Belgium • Bosnia and Herzegovina • Bulgaria • Croatia • Czech Republic •Denmark • Estonia • Finland • France • Germany • Georgia • Greece • Hungary • Iceland • Ireland • Italy • Kazakhstan • Latvia • Lithuania • Luxembourg • Malta • Montenegro • The Netherlands • Norway • Poland • Portugal • Republic of Macedonia • Romania • Russian Federation • Serbia • Slovak Republic • Slovenia • Spain • Sweden • Switzerland • Turkey • Ukraine • The United Kingdom

Table of Contents

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List of Abbreviations

AB	Appellate Body
Art./Arts.	Article/Articles
Doc.	Document
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
e.g.	*exempli gratia*, for example
EC	European Communities
ENR	Exporter of National Relevance
FCB	Fixitanian Central Bank
FG	Fixitanian Government
FSEGSJ	Fixitanian Stability, Economic Growth and Social Justice Act
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade 1994
Id.	The same
i.e.	*id est*, that is
IMF	International Monetary Fund
No.	Number
p./pp.	page/pages
para./paras.	paragraph/paragraphs
REOFI	Regulatory Emergency Ordinance for Financial Institutions
SCM	Agreement on Subsidies and Countervailing Measures
SDR	Special Drawing Right
U.S.	United States

VCLT	Vienna Convention on the Law of Treaties
Vol.	Volume
WTO	World Trade Organization

Summary of Arguments

I. FIXITANIA'S REOFI DOES NOT BREACH GATS ART. XVII OR PARA. 2 OF THE ANNEX ON FINANCIAL SERVICES.

- The language of para. 2 evinces a broad scope of application that exempts prudential, last-resort measures such as Fixitania's REOFI legislation.
- The FG implemented the REOFI for prudential reasons and as a valid exercise of its regulatory discretion, since domestic and foreign banks have important structural discrepancies.
- The REOFI was not, and is not, a means for avoiding Fixitania's GATS commitments.
- Fixitania's REOFI is also defensible under GATS Art. XIV(a), because the legislation was necessary for maintaining public order in Fixitania. Alternative mechanisms to the REOFI were neither available nor sufficient to achieve the required protection from the financial crisis.
- The REOFI is not a disguised restriction on trade and was not applied in an arbitrary or unjustifiable manner.

II. FIXITANIA'S DUAL EXCHANGE-RATE REGIME IS NOT A SUBSIDY AND THEREFORE IS NOT PROHIBITED UNDER THE SCM AGREEMENT.

- Fixitania's dual exchange-rate regime is not a subsidy under the SCM Agreement, which requires that either a governmental financial contribution or income or price support confer a benefit on a specific recipient.
- The regime is not a financial contribution by the FG, because it does not involve a direct transfer of funds, foregone government revenue, or a good service outside "general infrastructure."
- The regime was not implemented in order impact prices or income, and accordingly does not qualify as income or price support under WTO jurisprudence.
- There is insufficient evidence that the regime confers a measurable benefit upon ENRs as a correlation does not prove a causal relationship and numerous factors other than the exchange rate might have led to the price differential between Fixitanian and Libertanian hybrid car manufacturers.
- Any relative reduction in costs for Fixitanian exporters is likely marginal and transitory.

III. Fixitania's fixed exchange rate for ENRs is consistent with GATT Art. XV:4.

- A violation of GATT Art. XV;4 requires a violation of a specific GATT provision; since the dual exchange-rate regime does not breach any such provision, it is consistent with Art. XV;4.
- Though the fixed exchange-rate regime is an exchange action, it does not amount to an appreciable departure from any GATT article and thus does not frustrate the intent of the GATT under Art. XV:4.
- The dual exchange-rate regime is not a trade action, but even if it is, only the IMF may determine whether it frustrates the intent of the IMF Arts. of Agreement.
- In the absence of a legal finding by the IMF that Fixitania's regime violates the IMF Arts. of Agreement, the WTO cannot find that Fixitania's regime violated the IMF.
- Should the panel find that the exchange-rate regime is subject to GATT Art. XV:4, it falls within the exception in GATT Art. XV:9 because it is an exchange restriction consistent with the IMF Arts. of Agreement.

Statement of Facts

1. Fixitania and Libertania are developed WTO members. An open and trade-oriented economy, Fixitania's largest trading partner is Libertania.

2. In the wake of the 2007 global economic crisis, the Fixitanian Government ("FG") took steps to protect the economic stability and financial health of Fixitania. In 2007, the FG passed the Regulatory Emergency Ordinance for Financial Institutions (the "REOFI"), which provides guarantees for savings deposits in banks in Fixitania. The REOFI's reach extended to banks with a majority of domestic shareholders. Regrettably, some banks with a majority of foreign shareholders were adversely impacted by the REOFI measures.

3. In 2008, the FG enacted the Fixitanian Stability, Economic Growth and Social Justice Act (the "FSEGSJ") to combat the country's declining GDP and rising unemployment. The legislation upheld freedom of payments and encouraged investments in the manufacturing sector. The FSEGSJ also introduced a dual exchange-rate system, with a fixed exchange rate for export transactions of Fixitanian exporters that register as "Exporters of National Relevance" (ENRs). ENRs may exchange their foreign reserve income through the Fixitanian Central Bank (the "FCB") at an exchange rate that is fixed against the currency of Libertania, the Libertado. Other transactions are subject to the free-floating exchange rate.

4. The FSEGSJ's measures resulted in concrete improvements in the Fixitanian economy. Greater investments were made in the engineering and manufacturing of hybrid cars in Fixitania, and in Libertania, those cars sell for 20% below the hybrid cars produced by Libertanian manufacturers. Moreover, in 2011, Fixitania enjoyed trade surpluses of 100 and 200 billion Special Drawing Rights ("SDRs") against Libertania and the rest of the world, respectively. Though the IMF has stated that the Fixi set by the FG is undervalued, it did not find that Fixitania's exchange-rate regime breached the IMF Articles of Agreement. The only other group to find that the FG's fixed exchange rate undervalues the Fixi is a group of Libertanian economists.

Identification of WTO Measures at Issue

Measure 1: The REOFI's bank savings guarantee program to banks with majority of domestic shareholders.

Measure 2: Fixitania's dual exchange-rate regime, including an undervalued fixed exchange-rate for ENRs.

Legal Pleadings

I. FIXITANIA'S REOFI DOES NOT BREACH GATS ART. XVII OR PARA. 2 OF THE ANNEX ON FINANCIAL SERVICES.

1. REOFI falls under the prudential exception in para. 2 of the Annex on Financial Services.

a. **The language of para. 2 evinces a broad scope of application.**

1. Para. 2 of Annex on Financial Services provides for a prudential 'carve-out': "Notwithstanding 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. 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."[1]

2. No respondent has invoked the prudential exception before the WTO DSB. Customary rules of interpretation of international law and the VCLT privilege the ordinary meaning of words in their context and in light of the object and purpose of the treaty.[2] The word "[n]otwithstanding" in para. 2 indicates that a measure falling within the ambit of the exception would be legal even if it was inconsistent with other GATS provisions.[3] Measures enacted "for prudential reasons" are covered *a priori*.[4] The omission of the term "necessary" signifies that a less-trade-restrictive alternative analysis, relevant to the GATS Art. XIV(a) public order exception, is inapplicable in this context.[5] That is, the measure cannot be challenged on the grounds that alternative GATS-

[1] Annex on Financial Services, para. 2.
[2] VCLT, Art. 31; s*ee also* DSU, Art. 3.2.
[3] Financial Services Background Note (2010) [28].
[4] *Id.* at [29].
[5] ABR, *U.S.—Gambling* [309–11].

consistent policy options are reasonably available and achieve the same result.[6] The GATS preamble recognizes “the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives.”[7] In light of the purpose of the GATS, para. 2 should be construed to grant a member wide latitude to pursue prudential policy measures to satisfy regulatory objectives.[8]

3. Para. 2 includes a qualification that measures not be used “as a means of avoiding the Member’s commitments or obligations.” The Oxford English Dictionary defines “avoid” as “to make void or of no effect” or “to invalidate.”[9] This suggests a holistic evaluation of whether a measure is *primarily* utilized to frustrate the effect of a member’s GATS commitments. Prudential measures that partially frustrate a member’s commitments or result in some inadvertent discriminatory effect would not *ipso facto* violate this provision.

4. The FG’s national treatment obligation in the financial services sector does not extend to emergency regulatory measures undertaken for prudential reasons. Fixitania has undertaken a commitment to financial services in accordance with the “Understanding on Commitments in Financial Services.” According to the Understanding, with respect to national treatment, “each Member shall 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. This paragraph is not intended to confer access to the Member's lender of last resort facilities.”[10] “Ordinary course of business” implicitly excludes emergency measures undertaken during a financial crisis. Access to a member’s lender of last resort facilities is explicitly exempted from the ambit of the national treatment commitment. A bank savings guarantee scheme serves an analogous function as a lender of last resort since it helps to ensure a bank’s access to funding by bolstering market confidence and deterring bank runs.[11] The national treatment obligation does not preclude FG from undertaking emergency funding measures outside of the ordinary course of business.

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[6] Key (2005), p. 25.
[7] GATS, Preamble.
[8] Von Bogdandy & Windsor (2008).
[9] Oxford English Dictionary (2013).
[10] Understanding on Commitments in Financial Services, para. C(1).
[11] Schich (2008), p. 59.

b. **The REOFI was a valid exercise of regulatory discretion by the FG and was implemented for prudential reasons, not as a means to avoid the FG's GATS commitments.**

5. Fixitania implemented a bank savings guarantee program for prudential reasons. The Fixitanian economy was deeply impacted by the global financial and economic crisis. Because Fixitanian banks had been borrowing short-term in U.S. dollars in the global financial markets and had lent long-term to foreign borrowers, the credit crisis threatened the solvency of domestic banks.[12] The REOFI was intended to ensure the integrity and stability of the financial system and to protect depositors and other persons who were owed a fiduciary duty by Fixitanian banks. A government guarantee of bank savings bolstered market confidence in these institutions by discouraging depositors from withdrawing funds and preempting a potential banking panic triggered by the collapse of a single institution.[13]

6. The exclusion of foreign banks from the REOFI is not a means to avoid the FG's national treatment obligations. Foreign and domestic banks have structural discrepancies that explain disparate treatment. Domestic banks are generally of greater importance for the provision of liquidity for the domestic economy than foreign banks.[14] The majority of banks in Fixitania are domestic and the size of domestic deposits in domestic banks is greater than in foreign subsidiaries.[15] Additionally, domestic banks were more exposed to risk as a result of currency fluctuations and their involvement in short-term lending on global financial markets. Foreign banks did not face a commensurate level of risk. Foreign-owned subsidiaries in Fixitania could potentially rely on the support of their parent institutions overseas to mitigate exchange-rate and borrowing risks.[16] Foreign parent banks have a vested interest in supporting their subsidiaries in order to avoid reputational damage that might undercut the parent bank's borrowing capacity in international markets.[17]

7. There was a prudential purpose behind extending the REOFI's coverage according to nationality rather than territoriality. The global economic crisis was an emergency that demanded prompt and effective policy action by all governments. Since every government was aware of the

[12] Record [4].
[13] *See* Honohan & Klingebiel (2000), p. 6.
[14] *See* Hocke (2012), pp. 186–187.
[15] Clarifications [108, 109].
[16] *See* Ashcraft (2008), p. 290; Houston, Marcus, & James (1997), p. 138.
[17] *See* Borchgrevink & Moe (2004), p. 159.

financial crisis, the most efficient division of labor was for each state to focus on the stability of its domestic financial institutions. One commentator on the financial crisis noted: "The alternative – each government focus[ing] on the domestic market participants instead of the national institutions – involves the difficulty [of] assess[ing] each participant's market share in the domestic market and stabiliz[ing] it according to this share … seems highly ineffective."[18] Since FG regulators do not have access to the financial information and balance sheets of a foreign subsidiary's parent bank, and because international banking conglomerates are often managed in a consolidated company-wide manner, FG regulators cannot effectively monitor the financial health of Fixitanian subsidiaries.[19] Therefore, the FG cannot implement deposit guarantees for foreign subsidiaries in a prompt and effective manner. The issue is best reserved for regulators in the parent bank's home country, who have broader access to the holding bank's financial information. Insuring foreign-owned banks might also precipitate a moral hazard by encouraging multinational financial institutions to transfer assets to their Fixitanian subsidiaries in anticipation of insolvency.[20] The FG might then effectively assume liability for the overseas commercial risks of foreign banks, which would overwhelm the budgetary resources of FG.

8. The extension of the REOFI beyond the 2007 financial crisis is not a means of avoiding FG's trade obligations. An indefinite government guarantee is imperative to reassure uncertain markets of the strength of the FG's commitment to financial stabilization. Specifying a premature termination date could undermine public confidence in the domestic banking sector and encourage the migration of capital away from banks, spurring a liquidity crisis.[21] With an indefinite guarantee, FG regulators can continue to monitor the financial health of the domestic banking sector and evaluate the merits of the REOFI accordingly.

2. Fixitania's bank savings guarantee program is also defensible under the GATS Art. XIV(a) public order exception.

9. GATS Art. XIV enables members to derogate from their obligations under GATS subject to specific conditions. GATS Art. XIV(a) exempts measures necessary to maintain public order. A footnote clarifies that "[t]he public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society." The panel in

[18] *See* Hocke (2012), p. 187.
[19] *See* Eisenbeis & Kaufman (2007), pp. 9–12.
[20] *See id.* at 12.
[21] *See* Hoskins (2012), p. 4.

US—Gambling clarified that "Members should be given some scope to define and apply for themselves the concepts of 'public morals' and 'public order' in their respective territories, according to their own systems and scales of values."[22]

a. **The REOFI is necessary for the maintenance of public order in Fixitania.**

10. The AB has indicated that a determination of necessity requires a "weighing and balancing" of several factors.[23] These include the "'relative importance' of the interests or values furthered by the challenged measure," the "contribution of the measure to the realization of the ends pursued by it," and "the restrictive impact of the measure on international commerce."[24] Once the party invoking the exception makes a *prima facie* case that a measure is "necessary," the complainant bears the burden to propose less trade-restrictive alternatives that are both "reasonably available" and achieve the "desired level of protection with respect to the objective pursued."[25] Alternatives that impose an "undue burden" on a member, including prohibitive costs or technical difficulties, are not considered reasonably available.[26]

11. The meltdown of the national financial system in 2007, and the concomitant fallout on the real economy, posed a serious threat to fundamental societal interests and public order. A government bank savings guarantee initiative substantially contributed to sustaining market confidence in domestic banking institutions and deterring a liquidity crisis.[27] The continuation of the REOFI after the economic recovery does not signify that the program is non-provisional. Rather it reflects a strategic calculation that an unspecified time frame and continued regulatory supervision is necessary to ensure that financial stabilization is not transitory.

12. Although the REOFI excluded majority foreign-owned banks from coverage, less-inconsistent alternatives were neither reasonably available nor sufficient to achieve a desired level of protection. Expanding coverage to include foreign bank subsidiaries might have greatly expanded deposit liabilities, making the program prohibitively costly for the FG in the event of bank failures. Foreign banks experiencing financial problems or exposed to market risk would have an incentive to transfer capital to their Fixitanian subsidiaries to take advantage of the

[22] PR, *U.S.—Gambling* [6.461].
[23] ABR, *U.S.—Gambling* [307].
[24] *Id.* at [306–310].
[25] *Id.* at [309–311].
[26] *Id.* at [308].
[27] *See* Schich (2008), p. 59; Honohan & Klingebiel (2000), p. 6.

governmental guarantee.[28] Since FG regulators do not have access to the financial records of overseas parent banks, they cannot evaluate and monitor this risk.[29] In the event that a multinational bank became insolvent, the FG could have been liable for an immense inventory of global assets held under the title of that bank's Fixitanian subsidiary, creating an undue burden for the FG. Alternatively, designing facially neutral criteria for the REOFI, such as the financial health of the bank or its importance within the financial system, would have entailed considerable technical difficulty. Since regulators would have needed to determine the eligibility of individual banks, it would have delayed the pace of implementation during a financial crisis when efficacy was contingent on speed.

b. **The REOFI was not applied in an arbitrary or unjustifiable manner and did not constitute a disguised restriction on trade.**

13. The chapeau in GATS Art. XIV prohibits members from applying measures "in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services." The AB has clarified with regard to the GATT Art. XX chapeau that the "analysis of whether the application of a measure results in arbitrary or unjustifiable discrimination should focus on the cause of the discrimination, or the rationale put forward to explain its existence."[30] The AB has referred to GATT Art. XX jurisprudence in elucidating the requirements of the GATS Art. XIV chapeau.[31]

14. The exemption of foreign banks from the REOFI was justifiable. The FG prioritized the protection of domestic banks because they played a crucial role in the provision of liquidity for the domestic economy.[32] Domestic banks were also particularly susceptible to the risk of currency fluctuations and a possible credit crunch as a result of heavy reliance on short-term borrowing prior to the crisis. Foreign subsidiaries were less vital to the provision of liquidity and the stability of the domestic financial system,[33] and were more insulated from adverse market conditions given their potential access to credit and foreign currency from their parent banks

[28] *See* Goldberg et al. (2005).
[29] *See* Eisenbeis & Kaufman (2007), pp. 9–12.
[30] ABR, *Brazil—Tyres* [226].
[31] ABR, *U.S.—Gambling* [342–43].
[32] *See* Hocke (2012), p. 187.
[33] *Id.*

overseas.[34] The FG's focus on domestic institutions was warranted by their elevated level of risk and their disproportionate importance to the domestic economy.

II. **FIXITANIA'S DUAL EXCHANGE-RATE REGIME IS NOT A SUBSIDY AND THEREFORE IS NEITHER PROHIBITED NOR ACTIONABLE UNDER THE SCM AGREEMENT.**

15. The dual exchange-rate regime established by the FG is not a prohibited export subsidy under SCM Arts. 1 and 3 (1) (a). Fixitania's dual exchange-rate regime does not amount to a subsidy and, even if the panel finds it does, it is not export contingent.

1. The dual exchange-rate regime is not a subsidy under SCM Arts. 1, 2.

16. The SCM Agreement states that for a subsidy to exist, there must be (a) "a financial contribution by a government or any public body" *or* any form of income or price support according to GATT Art. XV that (b) confers a benefit on (c) a specific recipient.[35] Fixitania's dual exchange-rate regime fails to meet these criteria.

a. **Fixitania's dual exchange rate is not a financial contribution by the FG.**

17. SCM Art. 1.1 states that a government can contribute financially to a business in four different ways: (a) a "direct transfer of funds"; (b) "government revenue . . . foregone or not collected;" (c) government provision of a good or service, other than general infrastructure; or (d) the government entrusts a private body to perform one of the first three functions mentioned above.[36] In *US—Export Restraints*, the panel found this list to be exhaustive.[37] It further noted that whether something is a financial contribution is not dependent on an "effects" test, and that not "every government intervention that might in economic theory be deemed a subsidy with the potential to distort trade is a subsidy."[38] Since Fixitania's dual exchange-rate regime does not fall under any of the four categories stated *supra*, it is not a financial contribution under SCM Art. 1.

i. Fixitania's dual exchange-rate regime does not involve a direct transfer of funds by the FG.

18. The SCM Agreement provides specific examples of what constitutes a direct transfer of funds for the purposes of a financial contribution: grants, loans, and equity infusion.[39] Each example involves the explicit transfer of public assets from the government to a private entity. In

[34] *See* Borchgrevink & Moe (2004), p. 159.
[35] SCM, Art. 1.1.
[36] *Id.*; Caryl (2011).
[37] PR, *U.S.—Export Restraints*, [8.62, 8.69].
[38] *Id.*
[39] SCM, Art. 1.1 (a)(i).

US—Export Restraints, the panel stated that "[t]he negotiating history confirms that items (i)-(iii) [of Article 1.1(a)(1)]. . . limit these kinds of [government] measures to the transfer of economic resources from a government to a private entity."[40] The exchange of currency under the dual exchange-rate regime does not entail a direct transfer of public assets from FG to a private entity. Rather, Fixitania's dual exchange-rate regime is a regulatory measure implemented in conjunction with capital export restrictions to prevent the drying-up of foreign currency reserves in Fixitania. Foreign currency reserves provide an important function as a precautionary tool against balance of payment crises.[41] Indeed, between the introduction of the fixed exchange rate in 2008 and 2011, the FCB accumulated foreign reserves worth approximately 500 billion SDRs, creating a healthy international reserve that could be deployed in the event of a crisis.[42] By operating a currency exchange window, the FG was not transferring assets to a private entity, but rather was accumulating valuable foreign currency reserves for the FG.

19. Alternatively, even if the panel classifies FG's dual exchange-rate regime as a transfer of funds, any such transfer is not direct. The Oxford English Dictionary defines "direct" as "without intervening factors or intermediaries." The alleged transfer of funds is a function of the exchange-rate differential between the fixed rate available to ENRs and the conversion rate available on the FCM. However, ENRs cannot directly realize a pecuniary gain from this differential because they are required to convert foreign exchange income at the fixed rate, and are denied access to the FCM. Moreover, capital export restrictions restrict the ability of ENRs to directly exploit the exchange differential through overseas investment. Any net benefit derived from conversion through the fixed exchange system would be indirect because it would depend on secondary transfers with intermediaries that exploited price discrepancies. Therefore, FG's dual exchange-rate system does not entail a direct transfer of funds to ENRs.

ii. The dual exchange-rate regime does not involve a foregoing of government revenue that is otherwise due.

20. Fixitania's dual exchange regime does not constitute a situation in which "government revenue that is otherwise due is foregone or not collected."[43] As the panel explained in *U.S.—*

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[40] PR, *U.S.—Export Restraints*, [8.65].
[41] Cook & Yetman (2011).
[42] Record, [7].
[43] SCM, Art. 1.1 (a)(1)(ii).

FSC, "in determining whether revenue foregone is 'otherwise due' [it is necessary] to look to the situation which would exist under a Member's tax regime in the absence of the measures in question."[44] In the absence of a dual exchange-rate system, the FG would not be collecting additional revenue from ENRs. Rather, as a result of the exchange-rate system, the FG is collecting foreign currency revenue from ENRs to boost its foreign exchange reserves. Thus, Fixitania's dual exchange-rate regime does not involve a foregoing of government revenue.

iii. Fixitania's dual exchange-rate regime is not a provision of a good or service other than "general infrastructure."

21. The FCB's precautionary accumulation of international reserves through a dual exchange-rate system cannot properly be characterized as a provision of goods or services under SCM Art. 1.1(iii).[45] Rather the exchange-rate regime was a means to regulate Fixitania's balance of payments problems and grow its foreign currency reserves. Although regulation like services provides "something of value,"[46] the two are distinct concepts and Art. 1.1(iii) is confined to services. ENRs that utilize the fixed exchange-system might not need to contract with a private party to hedge against foreign currency risk. However, indirectly rendering a private service unnecessary through regulation is not equivalent to supplanting that commercial service.

22. Even if the panel classifies a dual exchange-rate system as a service, it falls within the "general infrastructure" exception under SCM Art. 1.1(iii). In *EC-Aircraft*, the panel considered that the term "general infrastructure," "taken in its ordinary and natural meaning, refers to infrastructure that is not provided to or for the advantage of only a single entity or limited group of entities, but rather is available to all entities."[47] While eligibility for the fixed exchange window is reserved for ENRs, the accumulation of foreign exchange reserves as a precautionary buffer against a balance of payments crisis provides broader macroeconomic benefits for Fixitania. Due to their availability and liquidity, international reserves are an invaluable self-insurance tool against a sudden stop in international capital flows.[48] For example, Fixitanian banks used short-term international borrowing in US dollars to fund long-term loans. In the event of a crisis, international lenders might recall these loans. The FCB could then leverage its foreign

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[44] PR, *U.S.—FSC* [7.92].
[45] Mercurio & Leung (2009),, p. 1295.
[46] PR, *U.S.—Export Restraints*, [8.65].
[47] PR, *EC—Aircraft*,[7.1015, 7.1044].
[48] Cook & Yetman (2011); Aizenman & Lee (2005).

currency reserves to assist domestic banks in repaying their loans, averting a broader financial meltdown. Additionally, a strong foreign reserve portfolio can improve a country's credit rating, thereby reducing its borrowing cost.[49] The dual exchange-rate regime constitutes a general financial architecture that provides broader economic benefits.

b. **The dual exchange-rate regime is not a form of income or price support.**

23. Under SCM Art. 1.1(a)(2), Fixitania's dual exchange regime is a "form of income or price support within the meaning of Art. XVI."; this refers to "income or price support" as a "subsidy . . . which operates directly, or indirectly to increase exports of any product from, or to reduce any product into [a Member's] territory."[50]

24. The panel in *China—GOES* suggested that "income or price support" should be interpreted narrowly. The Panel noted that "it does not include all government intervention that may have an effect on prices…[and was not necessarily] intended to capture all manner of government measures that do not otherwise constitute a financial contribution, but may have an indirect effect on a market, including on prices."[51] Rather, the panel determined the conceptual focus "is on the nature of government action, rather than upon the effects of such action."[52]

25. This is further supported by AB reports concerning the Agreement on Agriculture. In the context of agriculture, "income or price support" has been found to exist when a government commits to buying domestic agricultural products at a set price; that is, the government directly intervenes in the market to support income and prices by purchasing from the producer.[53]

26. Any impact of Fixitania's fixed exchange-rate regime on ENRs is incidental. Fixitania's dual exchange-rate system is by nature a regulatory instrument intended to help regulate capital movement and prevent the drying-up of foreign currency reserves. Unlike price-setting regimes in the context of agriculture, the FG is not directly intervening in the market to purchase the products of ENRs at a guaranteed high price in order to provide income support. The pricing policies of Fixitanian exporters like hybrid car manufacturers is based on myriad factors such as

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[49] Williams (2005).
[50] Caryl (2011), p. 198.
[51] PR, *China—GOES* [7.85].
[52] *Id*.
[53] ABR, *Canada—Milk*; ABR, *Korea—Beef*.

business plan, productivity, cost structure etc.[54] Any impact on prices and income of ENRs by the fixed exchange-rate regime is incidental rather that intentional.

c. **The dual exchange-rate regime does not confer any measurable benefit upon ENRs.**

27. SCM Art. 1.1(b) requires that, for a subsidy to exist, a benefit must be conferred as a result of the financial contribution by the government or the income or price support.[55] In *Canada-Aircraft*, the AB explained that "the ordinary meaning of 'benefit' clearly encompasses some form of advantage" and that one needs to determine whether the recipient is "better off" than it would have been absent the contribution.[56] The AB also stated that "the only logical basis for determining the position [of] the recipient . . .absent the financial contribution is the market."[57]

28. ENRs are not advantaged by the dual exchange-rate regime as they cannot realize immediate trading profits from exchange-rate disparities between the fixed exchange rate and the freely traded FCM rate. In recent years, the FCM has afforded a higher valuation for the Fixi than the FG administered rate.[58] However, ENRs are required to exchange foreign reserve income from export transactions with the FCB and cannot use the FCM.[59] Such a restriction proscribes ENRs from reverse selling Fixis obtained from the FCB on the FCM. As a result of capital export restrictions, once ENRs have repatriated foreign earnings through the FCB, they cannot freely engage in arbitrage through overseas investment.

29. Furthermore, there is insufficient evidence to establish that the fixed exchange rate has conferred a competitive advantage to ENRs. For example, the success of Fixitanian hybrid car manufacturers vis-à-vis their Libertanian competitors has been erroneously attributed to the beneficial impact of the fixed exchange-rate. Fixitanian hybrid cars are being sold at a retail price 20% lower than hybrid cars produced in Libertania, enabling them to gain foreign market share. However, a correlation between the implementation of a fixed exchange rate and pricing disparities between Libertanian and Fixitanian hybrids is insufficient to prove a causal relationship. Capital export restraints and the restructuring of the financial services sector channeled domestic capital into hybrid car manufacturing. Enhanced investment might have

[54] Clarification [135].
[55] SCM, Art. 1.1(b).
[56] ABR, *Canada—Aircraft* [157]; PR, *EC—Aircraft* [7.382].
[57] ABR, *Canada—Aircraft* [157].
[58] Clarification [227].
[59] Clarification [78].

enabled hybrid car manufacturers to expand production capacity and achieve greater efficiency through economies of scale. Other factors such as innovation, or wage reduction as a result of rising unemployment during the crisis, might have allowed Fixitanian hybrid car companies to reduce prices. That the business setbacks of Libertania automakers are unrelated to the FG's exchange-rate policy is supported by the absence of complaints by hybrid carmakers in other countries as well as by Libertanian industry groups in other sectors.[60] Thus, there is inadequate evidence to establish that the fixed exchange-rate bestowed a competitive advantage to ENRs.

30. Any relative reduction in input costs for Fixitanian exporters caused by an undervalued exchange rate is likely marginal and transitory. When an undervalued exchange-rate system is initially implemented, an exporter whose foreign retail prices remained consistent earns a numerically larger sum of revenue in domestic currency. Since inputs like labor are generally priced in the domestic currency, an undervalued exchange rate translates into lower production costs. However, over time, domestic prices adjust. The FCB's purchase of an unlimited supply of foreign earned income from ENRs increases Fixitania's monetary base, potentially stoking inflation.[61] As prices adjust, the real effects of exchange intervention decrease to zero.[62] Furthermore, exporters that depend heavily on imported inputs might fail to accrue any initial cost advantage since they would need to purchase these imports according to a market-based exchange rate. Thus, the economic impact of currency manipulation on ENRs is unclear and does not support the finding that a measurable benefit has been conferred upon ENRs.

III. FIXITANIA'S FIXED EXCHANGE-RATE FOR ENRS IS CONSISTENT WITH GATT ART. XV:4.

1. Fixitania's ENR currency peg to the Fixi does not violate Art. XV:4.

a. Fixitania's currency peg cannot be challenged under Art. XV:4 as there is no GATT violation, which is required for a Art. XV:4 violation.

31. Art. XV:4 requires contracting parties to refrain from "exchange action [that] frustrate[s] the intent of the provisions of [the GATT] and trade action [that frustrates] the intent of the provisions of the Articles of Agreement of the International Monetary Fund."[63] The *Ad Note* establishes that "infringements of the letter of any Article of Agreement by exchange action shall

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[60] Clarifications [152, 153].
[61] Staiger & Sykes (2010).
[62] *Id*.
[63] GATT Art. XV:4.

not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article."[64] Thus, Art. XV:4 is not a stand-alone provision: it requires as a necessary, but not sufficient, condition that an exchange action explicitly violate the letter of a specific GATT provision.[65] Since Fixitania's fixed currency regime for ENRs does not violate any GATT provision as established *supra*, Fixitania does not violate Art. XV:4.

b. **Fixitania's fixed exchange-rate regime is an exchange action but does not frustrate the intent of the provisions of the GATT.**

32.Under its ordinary meaning pursuant to VCLT Art. 31, "exchange action" refers to "acts relating to the exchange rate" which is equivalent to "exchange rate-based measures".[66] GATT Arts. XV:3 and VIII support this umbrella definition, using the narrower terms "multiple rates of exchange" and "foreign exchange arrangements" respectively. The context of "exchange action" thus indicates that if the drafters hadn't intended for Art. XV to cover exchange-rate measures, they would have used narrower language.[67] This is also in line with the object and purpose of Art. XV:4 as undervalued exchange rates have similar effects on trade as other exchange actions like multiple exchange rates, which indisputably are covered by Art. XV.[68] It would thus be illogical for the Art. to cover multiple exchange rates and not undervalued exchange rates.[69] Indeed, the Travaux Preparatoires reflect the drafters' concern about the use of par value currency manipulation and exchange-rate controls to restrict market access,[70] further suggesting that Art. XV:4 was included to ensure protection against the manipulation of exchange-rate controls and restrictions.[71] Thus, Fixitania's policy of pegging the Fixi to the Libertania is an exchange-rate policy encompassed by the umbrella definition of "exchange action."

33. While Fixitania's currency peg for ENRs is an exchange action, it does not violate the intent of the GATT. As stated in *Ad Note* to Art. XV:4, for an exchange action to frustrate the intent of the GATT there needs to be an "*appreciable departure* from the intent of the Article."[72]

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[64] Ad Note to GATT Art. XV.
[65] Zimmermann (2011), p. 471; *see also* Mattoo & Subramanian (2008), p. 4.
[66] Hudson et al. (2011), p. 30.
[67] Miranda (2010), p. 119.
[68] *Id.*
[69] *Id.*
[70] Miranda (2010).
[71] Zimmermann (2011), p. 470.
[72] Ad Note to GATT Art. XV:4 (emphasis added).

Fixitania's exchange actions do not meet this elevated standard. As established *supra*, Fixitania did not violate a substantive GATT provision; and without such violation, Fixitania cannot possibly "appreciably depart" from the intent of specific Arts. of the GATT. This is further supported by the fact that in 1950, more than half of all exchange regimes involved dual or multiple exchange rates, but not one of which has been deemed illegal under Art. XV:4.[73]

c. Fixitania's fixed exchange rate for ENRs is not a trade action and does not frustrate the intent of the IMF Arts. of Agreement in the absence of such a finding by the IMF.

34. While the ENR exchange rate for the Fixi could potentially affect the flow of goods from Fixitania, it does not constitute a trade action. Under its ordinary meaning pursuant to VCLT Art. 31, trade is "the action of buying and selling goods and services."[74]The context, object and purpose of the Art. clarify that "trade action" was meant to refer to actions of trade, not actions that indirectly effect trade. Not only would it have been superfluous for the drafters to include exchange action and trade action in one provision if both terms could cover the same action; it would also go against the object of Art. XV:4—to clarify the relationship between the IMF and the WTO—as it blurs the distinction created in the Art. for IMF and WTO involvement. If the drafters had intended for exchange actions with an effect on trade to be considered trade actions, they would have chosen words to reflect this, like "actions that affect trade" or similar terms, not "trade action".[75] Thus, "trade action" does not encompass actions that merely have a trade *effect*, including Fixitania's fixed exchange rate for ENRs.

35. Even if the panel considers the ENR exchange rate for the Fixi a trade action, only the IMF, not the panel, can determine whether such action frustrates the intent of the IMF Arts. of Agreement. An earlier GATT panel considered whether a special import tax instituted by Greece constituted a violation of Art. XV:4. The panel suggested that the issue fell within the jurisdiction of the IMF, noting that "the Contracting Parties [. . .] address an inquiry to the International Monetary Fund as to whether the Greek "contribution" . . . is in conformity with the Articles of Agreement of the International Monetary Fund."[76] To date, the IMF has not made a legal determination that Fixitania's fixed exchange rate for ENRs constitutes a violation of the

[73] Reinhard & Rogoff (2004), p. 6.

[74] Oxford English Dictionary (2013).

[75] Mercurio & Leung (2009), p. 1286.

[76] Greece Special Import Taxes (1952); *see also* Jackson (1969), p. 485.

IMF's Arts. In the absence of such a determination, it is impossible for the panel to conclude that Fixitania violated the intent of the IMF provisions.

2. <u>If the panel finds that GATT Art. XV:4 is applicable, Fixitania's ENR exchange rate for the Fixi will fall under the exception to Art. XV:4 provided for in Art. XV:9.</u>

a. **GATT Art. XV:9 is an exception to GATT Art. XV:4**

36. Art. XV:9 carves out an exception to Art. XV:4 for "exchange controls" or "exchange restrictions" that are in accordance with the Arts. of Agreement of the IMF.[77] While Art. XV:9 is in tension with Art. XV:4, it trumps Art. XV:4 according to the *Lex Specialis* principle, as it is more specific. First, Art. XV:9 refers to exchange controls and restrictions consistent with the IMF Arts. of Agreement; Art. XV:4, however, makes reference to exchange actions in general, and is thus not limited to the IMF Arts.[78] Second, the term "exchange action" of Art. XV:4 is broader than the terms "exchange control" and "exchange restriction" of Art. XV:9. A measure is an exchange restriction if it "involves a direct governmental limitation on the availability or use of exchange as such."[79] "Exchange controls" include all nonrestrictive exchange measures.[80] "Exchange action" refers to acts relating to the exchange rate, which includes both "exchange control" and "exchange restriction." Thus, Art. XV:9 is more specific than Art. XV:4 and takes precedence.[81] As a result, an exchange restriction or control in accordance with the IMF provisions does not violate Art. XV:4 and cannot be challenged under the GATT.[82] This conclusion is further supported by the 1952 GATT panel decision mentioned *supra.* With regards to whether Greece's contribution requirement violated national treatment under Art. III, the panel stated that if "the Fund should find the tax system was a multiple currency practice and in conformity with the Articles of Agreement of the International Monetary Fund, it would fall outside the scope of Article III."[83]

b. **Fixitania's ENR fixed exchange-rate regime is covered by the exception in Art. XV:9 as it is an exchange restriction consistent with the IMF Arts. of Agreement.**

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[77] GATT, Art. XV:9.
[78] Koops (2010), p. 12.
[79] Zimmermann (2011), p. 464.
[80] *Id*. at p. 465.
[81] Koops (2010), p. 12.
[82] *Id*.
[83] Jackson (1969), p. 484; Siegel (2002), p. 561.

37. For the purposes of Art. XV:9, Fixitania's measures employed to fix the Fixi against the Libertado would amount to an "exchange restriction" as defined *supra*. Requiring ENRs to exchange their foreign reserve income at a fixed exchange rate involves a direct government limitation on the availability and use of currency exchange. ENRs are no longer able to spend or exchange their foreign income in a way other than through exchanging it for Fixi through the government-owned FCB, thus limiting the amount of foreign currency in Fixitania.

38. Fixitania's ENR fixed exchange rate is consistent with the IMF Arts. of Agreement. While IMF members cannot restrict payments and transfers for transactions without the approval of the IMF, IMF Art. VI:3 provides IMF members the right to regulate international capital movements, including both restrictive and nonrestrictive exchange measures, without getting specific approval.[84] As such, "a formal finding by the IMF that their use is not in accordance with the IMF Agreement [. . .] is a prerequisite for proceeding to a finding of breach under the GATT 1994."[85] While the IMF has recognized that the ENR exchange rate for the Fixi is "significantly undervalued," it has not found that Fixitania's exchange-regime violated the IMF Arts. of Agreement. In the absence of such a finding, the panel cannot find that Fixitania's actions are exchange restrictions that violate the IMF Arts. of Agreement.

39. This is further supported by policy considerations. The IMF and the WTO are separate organizations, each vested with the exclusive authority to determine whether an action complies with the institution's distinct legal provisions. The WTO would be overstepping its mandate if it were to speak out on whether an action is IMF-compliant. It is analogous to the issue of national security. While GATT Art. XXI (c) provides that nothing in the GATT shall "prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security," it will defer to the judgment of the UN Security Council to find a violation of Art. XXI (c). Similarly, the WTO should not foray into an area that the drafters and current policymakers wish to carve out of the WTO purview: monetary policy. Thus, in the absence of an IMF determination that a measure violates its Arts. of Agreement, we can assume that the measure did not violate the IMF Arts. of Agreement, and that Fixitania's fixed exchange rate for ENRs did not violate GATT Art. XV:4.

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[84] Zimmermann (2011), p. 465.
[85] *Id*.

Request for Findings

For the above stated reasons, Fixitania requests the panel to:

i. Find that the REOFI does not breach GATS Art. XVII or para. 2 of its Annex on Financial Services.

ii. Find that the FSEGSJ does not breach the SCM Agreement.

iii. Find that the FSEGSJ does not breach Art. XV:4 of the GATT in conjunction with the provisions of the IMF Arts. of Agreement.