THE ‘MISSING LINK’ BETWEEN THE WTO AND THE IMF

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ABSTRACT
This article is part of a broader study on the impacts of exchange rate on trade. It searches for an explanation on why there is no effective rule in the World Trade Organization (WTO) to neutralize the negative impacts of currency misalignments on trade instruments. In other words, it searches for the missing link between the WTO and the International Monetary Fund (IMF) concerning the relationship between exchange rates and trade. It also seeks to demonstrate that, in the creation of the Bretton Woods system this link was clearly defined but was forgotten after the end of the par value. Despite all the historical and theoretical developments these two organizations have been through, their only legal link remains the same: General Agreement on Trade and Tariffs (GATT) Article XV. The article analyzes the differences between the IMF Article IV approach based on the concept of manipulation of exchange rates and the GATT Article XV approach that looks for the frustration of the trade objectives. Finally, it argues for the rescue of GATT Article XV to solve the serious problem of trade rules circumvention through currency misalignments.

INTRODUCTION

I am gratified to announce that the Conference at Bretton Woods has completed successfully the task before it. It was, as we knew when we began, a difficult task, involving complicated technical problems. We came here to work out methods which would do away with the economic evils – the competitive currency devaluation and destructive impediments to trade – which preceded the present war. We have succeeded in that effort.

Henry Morgenthau, Jr, US Secretary of the Treasury
President of the Bretton Woods Conference

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When the articles of the General Agreement on Trade and Tariffs (GATT) were negotiated in 1947, during the United Nations (UN) Conference on Trade and Employment, the contracting parties were concerned about the damaging effects of exchange rate manipulation on trade policy instruments. The chaotic consequences to trade of the practice of competitive currency devaluation in the years before the World War II were still very present in the minds of the negotiators.

The issue was seemingly settled, though, by the fixed exchange rate system established in Bretton Woods. With exchange rates controlled under International Monetary Fund (IMF) auspices, the subject was not made present more than a few times in the GATT. Article XV of GATT, in its paragraph 4, established that ‘contracting parties shall not, by exchange actions, 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 IMF’.

Article IV of the IMF Articles of Agreement, by its turn, established a firm control over exchange rates, determining that exchange rates would not vary more than 1% from the par value established and that members would undertake ‘to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations’.

Article XV of the GATT and Article IV of the IMF would thus form the primary bond between the two regulatory systems, guaranteeing that exchange rates would not be of concern to international trade as long as the fixed exchange rate system was in place. The multilateral trading system could then develop with relative indifference to exchange rate issues.

After more than 60 years of historical and theoretical developments, these two systems suffered major modifications, both in their structure as in their agendas. These modifications have had a great impact in each regulatory system, as each had to evolve to deal with the new challenges present in the international arena. However, after the end of the fixed exchange rate system in the 70s and the IMF’s loosened control over exchange rates, the Article IV of the IMF gradually lost its focus on exchange rates, as well as its central place in the Fund’s objectives, breaking the link between the two institutions.

Despite the efforts of coordination between the IMF and the World Trade Organization (WTO), mandated by Article III.5 of the Marrakesh Agreement and the agreement between the institutions (WT/L/195), the 2008 economic crisis brought its effects to the forefront of international economic tensions. Seeking a way out of recession, several countries maintained undervalued currencies (either directly or as an indirect consequence of expansionary monetary policies, such as non-conventional instruments of monetary policy) and chose to promote exports in order to stimulate...
economic growth. The impacts on international trade have surged and many state agents and scholars now criticize the IMF and the WTO for their incapacity to address the problem.

Two of the most influential scholars in international economics and international law of the past decades summarized well the deep concerns over the issue. John Jackson argues that there is a bitter division between trade and finance experts, stating the existence of a ‘hatred of the trade people compared to the financial people’:

> It causes real harm, because the problems of financial services, which are horrendous problems today, can really make life pretty miserable, and (it) is making life pretty miserable for millions and millions of people all over the world.

Fred Bergsten argues in the same line, stating further that:

> The failure to link the trade and currency issues is by far the most important single issue facing the global trading system and, indeed, international economic cooperation today. It represents the biggest structural flaw in the Bretton Woods system that was created in the end of the Second World War.

This article seeks to identify the origin of this ‘missing link’ through the history of IMF and WTO development.

I. THE POST-WAR INTERNATIONAL ECONOMIC SYSTEM

After the economic turmoil of the 30s and the following World War II, countries decided that international economic relations should be better regulated in order to preserve peace and foster development. Three international organizations were conceived out of this unique political moment, construing an institutional structure which would be responsible for global economic governance in the following decades: the International Bank for Reconstruction and Development (IBRD; the original institution of the five that now make up the World Bank Group); the IMF; and the International Trade Organization, which has not come into force, leaving only the GATT as its outcome.

1 The currency manipulation can be traced back to even before the financial crisis of 2008, arguably even being one of its underlying reasons, but the crisis has undeniably unveiled its full consequences. See BERGSTEN, Fred, and GAGNON, Joseph, ‘Currency Manipulation, the US Economy, and the Global Economic Order’, Policy Brief N. PB 12-25, Peterson Institute for International Economics, Washington, December 2012.


3 BERGSTEN, Fred, Keynote Speech at the VIII Annual Symposium on International Trade, Washington College of Law, American University, 17 October 2012.
The two Bretton Woods organizations, along with the surviving GATT, would be the basis for the economic relationship between the nations, guaranteeing that no country would resort to the protectionist and 'beggar thy neighbor' measures that had further worsened the economic crises of the 30s. While the IBRD would focus on financing reconstruction and poverty alleviation projects, the IMF would guarantee the fixed exchange rates system by assisting countries facing difficulties in their balance of payment. The GATT, by its turn, would regulate the fair trade between countries, fostering the liberalization of markets and the benefits of free trade. In this sense, 'the post-war system would encourage trade in goods, full employment, and stable currencies in a peaceful world'.

According to Douglas Irwin:

The Great Depression of the 1930s is a prime example—albeit rarely so recognized—of how exchange rate policies can create difficulties for trade policy. That decade saw a virulent outbreak of protectionist trade policies that contributed to a collapse of world trade. In fact, higher trade barriers accounted for about half of the 25 percent decline in the volume of global trade between 1929 and 1932 and stunted the growth of trade for the remainder of the decade.

Yet countries varied significantly in the extent to which they increased tariffs and imposed import quotas. A key factor in determining a country's trade policy response was not—perhaps surprisingly—the degree to which it suffered from falling output and rising unemployment, but rather its exchange rate policy under the gold standard.

Each one of these organizations, however, has since suffered deep transformations both in its mechanisms as in its overarching goals. The IBRD has grown to encompass several other objectives, from poverty reduction and development to promoting foreign investment, international trade and facilitating capital investment, as well as a growing concern with environmental issues. The IBRD is now part of a group of five international organizations known as the World Bank Group.

The GATT has developed into the WTO and its rules now regulate not only tariffs but technical barriers to trade, sanitary and phytosanitary regulation, services, intellectual property aspects of trade, and trade-related investment measures. Its dispute settlement system is a well-established law-giving entity and has helped to solve ambiguous and conflicting principles, enhancing free trade. The WTO has become one of the most important international fora where countries negotiate and supervise aspects of the global economic governance framework.

Finally, the IMF too has suffered major transformations. The IMF is arguably the Bretton Woods organization whose historical and theoretical


changes have had the most important impact on its goals and mechanisms. Some scholars call these changes a ‘Silent Revolution’ due to the fundamental changes underwent by the organization throughout the past 60 years.\(^6\)

These changes have had an impact not only on the organization, but on the whole Bretton Woods system coordination, as the IMF gradually changed its main stabilizing function in the international monetary system away from strict exchange rate control to a surveillance system focusing in balance of payment stability (or, more broadly, national stability) through financial support.

II. THE IMF’S ‘SILENT REVOLUTION’ AND THE FALL OF ARTICLE IV

The main purposes of the IMF’s creation were to avoid the exchange rate policies ‘anarchy’ of the 30s and a balance of payment crisis after the end of the war. In the minds of Keynes and White—the fathers of the organization—protectionist measures through currency manipulations were one of the main causes of economic downfall in the period. The idea was that if no country was allowed to devaluate its currency to gain a commercial advantage over its neighbor, the balance of payments of all countries would be protected and the system would not fall prey to a ‘race to the bottom’ to the likes of the great depression.\(^7\) The absence of a stabilizing international authority such as the IMF would ‘depress world economic growth and drive the world back into protectionist policies, regardless of how quickly or well production and trade could be reconstructed after the war’.\(^8\)

Exchange stability was to be guaranteed through a par value system based on the convertibility of US dollars to gold. All countries would have the obligation to maintain this par value, by the intervention of their central banks if needed be, within 1% of the value established by the Fund. The Fund would then help countries having difficulties in maintaining their par values through financial assistance. The primary objective of the system was to maintain the exchange rate equilibrium. The Article IV of the Articles of Agreement was, in this sense, the central legal obligation of the system.

Originally, Article IV read as following:

\begin{quote}
Article IV. Par Values of Currencies
Section 1. Expression of par values. – (a) The par value of the currency of each member shall be expressed in terms of gold as a common
\end{quote}


denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.

Sec. 3. Foreign exchange dealings based on parity. – The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity (i) In the case of spot exchange transactions, by more than one percent; and (ii) In the case of other exchange transactions, by a margin which exceeds the margin for spot exchange by more than the Fund considers reasonable.

Sec. 4. Obligations regarding exchange stability. – (a) Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. (b) Each member undertakes, through appropriate measures consistent with this Agreement, to permit within its territories exchange transactions between its currency and the currencies of other members only within the limits prescribed under Section 3 of this Article.

It would be possible, however, to alter this par value, after IMF’s acquiescence, in order to ‘deal with a fundamental disequilibrium’ between a currency value and the economic fundamentals of its country. This did occur on several occasions, the most notorious one being in 1967 when the UK announced a devaluation of 14.3% of its currency.

It is worth noting that not only the multilateral trading system depended upon the well-functioning of the par value system, but also several mechanisms under the original World Bank Articles of Agreement related to it. The par value system was, thus, central to the global economic governance institutional structure as conceived in Bretton Woods. In the words of Henry Morgenthau, Jr, US Secretary of the Treasury and President of the Bretton Woods Conference:

What are the fundamental conditions under which the commerce among the nations can once more flourish? First, there must be a reasonable stable standard of international exchange to which all countries can adhere without sacrificing the freedom of action necessary to meet their international economic problems. This is the alternative to the desperate tactics of the past - competitive currency depreciation, excessive tariff barriers, uneconomic barter deals, multiple currency practices, and unnecessary exchange restrictions – by

9 See e.g. its Art. II, s 9, dealing with ‘maintenance of value of certain currency holdings of the bank’. Also, it is revealing that members of the World Bank or contracting parties to the GATT were obligated to be members of the IMF or, at least, to have special exchange rate arrangements with each institution, but no similar obligation was inserted into IMF’s Articles of Agreement.
which governments vainly sought to maintain employment and uphold living standards. In the final analysis, these tactics only succeeded in contributing to world-wide depression and even war. The International Monetary Fund agreed upon at Bretton Woods will help remedy this situation.10

For a quarter of a century the system was relatively stable and concerns over competitive exchange rate devaluations were softened.11 Trade liberalization negotiators had not to worry about it and were free to tailor trade rules that were silent to the problem. In the late 60s, however, the system started to show signs of unsustainability.

The fixed system created some indirect effects such as the overvaluation of rich countries’ currencies and the undervaluation of several emerging economies. Albeit the possibility of change in the par values, this was severely discouraged by the system and countries often chose not to do so. This created situations like Japan’s that, by the early 70s, after attaining economic growth in double digits for several years, still maintained its currency at the same par value to the dollar as in 1949.

Furthermore, several authors already pointed out to the unsustainability of the fixed exchange rate system. In a seminal paper in 1953, Milton Friedman already warned that the fear of exchange rate flexibility was overrated since informed speculators would always tend to stabilize prices, not the other way around.12 By its turn, Robert Triffin argued that growing demand for dollar reserves would stress the system either to a crisis of confidence and a rush for gold or would push the world into deflation, in what became known as the Triffin Dylema.13 Finally, James Meade highlighted the negative effects cause by a fixed exchange rate regime to efforts of achieving external adjustment and balance of payment equilibrium, pushing countries into protectionist measures.14

The GATT’s safeguard mechanism was originally conceived to provide the necessary flexibility that would permit endangered countries to protect their

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10 MORGENTHAU, Henry Jr, Closing address to the Bretton Woods Conference, 22 July 1944.
11 Lowenfeld contrasts the perceived robustness of the IMF and World Bank systems compared to the difficulties faced by the GATT during the 50s and most of the 60s, while, by the end of the 80s and 90s it was the other way around. See LOWENFELD, Andreas F., International Economic Law (Oxford University Press, 2008), at 19. On the other hand, Lastra argues that the system was never really stable, showing important signs of stress during its relatively short life span. See LASTRA, Rosa M., Legal Foundations of International Monetary Stability (Oxford University Press, 2005), at 359–61.
balance of payments in the short term. These temporary barriers proved difficult to overcome even after the floatation of exchange rates.\textsuperscript{15}

By 1971, the Vietnam War had drawn heavily on America’s treasure and, after 6 years of war, the USA was no longer able to maintain the gold parity. On 15 August 1971, after a historical presidential speech, the USA declared the end of the convertibility of US dollars to gold. The episode, known as the ‘Nixon Shock’, hit heavily on the system’s core, sending shockwaves at all other fixed exchange rate values that now faced increased pressure to fluctuate.\textsuperscript{16} The fall of its centerpiece would mean the fall of the fixed exchange rate system.

Currencies started to freely flow and the adaptation process ended up being smoother than it had been expected. The Fund was called to face this new reality and to adapt. Economic theory had already changed from what it was in 1946 and the floating exchange rates were less viewed as a catastrophe. Furthermore, as the USA were no longer in a position to guarantee the basic mechanism of the system, it was no longer feasible in its original lines.

In 1972, the IMF’s Board of Governors created the ‘Committee on Reform of the International Monetary System’—the Committee of 20—with the mission of restructuring what was left of the system and adapting it. After two years of efforts, the Committee of 20 concluded its work and agreed on a program to help the monetary system evolve, focusing mainly on helping countries to overcome the oil price shocks. The IMF’s Executive Board later adopted the ‘Guidelines for the Management of Floating Exchange Rates’ as well as a new method of Special Drawing Rights (SDR) valuation based on a basket of 16 currencies, in an attempt to control the floatation process.\textsuperscript{17}

After several attempts, the Interim Committee agreed on an ‘interim reform’ of the monetary system, including the amendment of Article IV. A Second Amendment of IMF’s Articles of Agreement entered into force two years later, finally acknowledging the right of members to adopt exchange rate arrangements of their choice (Decision No. 5392-(77/63), adopted on 29 April 1977—the ‘1977 Decision’). The IMF members would now be free to choose between a set of exchange rate policies (except pegging their currency to gold): allowing the currency to float freely, pegging it to another currency or a basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.

\textsuperscript{15} See IRWIN, above n 5, at 32.


\textsuperscript{17} IMF, Guidelines for the Management of Floating Exchange Rates, Executive Board Decision No. 4232-74/67 (IMF, 1974).
By the end of the decade, the IMF had irreversibly changed its fundamental objective in global economic governance. The end of the Bretton Woods monetary system meant that its pivotal role in stabilizing a fixed rate system had to be overcome. The Fund now played a different role in the international economic system: that of guaranteeing the balance of payment of countries in a free floating exchange rate world. In this new role, it would not have the power to determine par values for currency exchange rates. The new mechanisms created to support this new role were based on conditional lending and systemic surveillance. In Rosa Lastra’s words:

The worldwide change from fixed floating exchange rates, following the collapse of the par value regime, also signified a more profound change in the nature of the IMF. There was a shift in emphasis from being primarily an international monetary institution focusing on issues such as exchange rate stability and convertibility, to becoming an international financial institution, with a broader array of responsibilities… The evolution of the role of the Fund over the past three decades has affected the practice of conditionality and the exercise of surveillance.  

In this sense, the Fund no longer exerted strict control over its members’ exchange rate arrangements. The Article IV now prescribed that:

Section 1. General obligations of members
Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members;…

The IMF would also exercise firm surveillance over the exchange rate policies of members as determined by Article IV, section 3:

Section 3. Surveillance over exchange arrangements
(a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.
(b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to

18 LASTRA, above n 11, at xvi.
those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member’s exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member’s choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members....

As the 1977 Decision established, the surveillance mechanism would be the one to ensure that countries did not revert to competitive exchange rate devaluation. However, in the coming years, even this mechanism would suffer changes from its initial role, becoming a more integral part of the IMF system by adding several macroeconomic considerations to the surveillance exercise and gradually relaxing its concern over exchange rate manipulations. The surveillance mechanism evolved, parting ways from the ‘firm surveillance over exchange rate policies’. As the IMF staff recognizes:

The 1977 Decision was crafted shortly after the collapse of the Bretton Woods system, in the midst of considerable uncertainty as to how the new system would work. It focused exclusively on surveillance over exchange rate policies, and its coverage was relatively narrow even in that area. The Decision was expected to be revised with experience. However, it remained virtually unchanged even as the practice of surveillance evolved (including to encompass domestic policies as a key element), and a disconnection developed between the Decision and the best practice of surveillance.

So far-reaching were the changes suffered by the IMF that some argue for the need of a ‘new fund agreement’ since the IMF ‘no longer described, let alone controlled, the international monetary system’. In practice, these changes meant not only the radical change of the Fund's main role but the fall of its Article IV.

A clear sign of the fundamental change of Article IV central place and strength can be perceived by the consequences of its violation. Under the original version of the IMF’s Articles of Agreement, countries that decided to alter their exchange rates without permission would be prevented from

21 See LOWENFELD, above n 4, at 582.
borrowing from the Fund. If the alteration persisted after a ‘reasonable period’, Article XV, section 2(b) would apply (Article IV, section 6). This article established the provisions by which a member could lose its membership in the Fund, and letter (b) made direct reference to the specific case in which a member would violate the obligations regarding exchange rate arrangements in connection to par values. A member in violation of Article IV could, therefore, by ‘a decision of the Board of Governors carried by a majority of the governors representing a majority of the total voting power’, be required ‘to withdraw from membership in the Fund’ (Article XV, section 2(b)).

In this sense Article IV not only contained an objective mechanism to assess compliance (the par value), but also carried specific provisions to punish members that failed to respect its obligations, leading, ultimately, to withdrawal of membership. On the other hand, under the reformed wording no direct reference is present in Article IV as to the consequences of failing to comply with its obligations. Article XXVI, section 2 (the equivalent of original Article XV, section 2) establishes the consequences of the violation by a member of its obligations to the Fund. Instead of the original reference to exchange rate obligations though, there is a direct reference to Article V (operations and transactions of the fund).

Also, the membership withdrawal became much more complex, requiring first that the member be suspended by a majority of 70% of the total voting power and then, after another reasonable period, a majority of 85% of the total voting power for a member to lose its membership.

With no mechanism to determine exchange rates, the Fund now concentrated its efforts in guaranteeing the financial health of a floating exchange rate system. The simple fact that the Fund now allowed countries to choose when and to which currencies to peg their currencies says a lot about the prohibition of currency manipulation after the fall of the par value system. Since the 1977 decision, the Fund had no substantive legal rights with respect to the choice of exchange arrangement of its members.22

The existence of such an article, disaggregated from the organization’s practices, is not to be seen with strangeness. The article VI of IMF’s Articles of Agreement, had the same fate due to the rise in importance of private capital flows to investments and balance of payment. Unpredicted by the Fund’s founders, the prohibition of lending to countries facing significant capital outflows and the possibility of the Fund to request a country member to ‘exercise controls to prevent such use’, contained in this article, were never invoked by the Fund, in a silent recognition of its modern inapplicability.23

22 See LASTRA, above n 17, at 402.
23 BOUGHTON, above n 8, at 11. François Gianviti argues that IMF Art. IV, s 1 has undergone a de facto transformation from hard law into soft law. See GIANVITI, François ‘Evolving Role and Challenges for the International Monetary Fund’, 35 International Lawyer (2001), at 1371–404.
In the last decade, the IMF was subject to criticism for its lack of surveillance over members’ exchange rate policies.²⁴ It was argued that the Article IV surveillance reports were not paying due attention to fundamental misalignments of some members currencies.²⁵ The tensions rising from the disputes between the USA and China on the issue led to the adoption by the IMF Executive Board of the Decision on Bilateral Surveillance Over Members’ Policies, on 15 June 2007.²⁶ This decision reviewed and replaced the 1977 decision, introducing a renewed focus on member’s exchange rate policies bringing ‘greater clarity and specificity to what exchange rate policies countries should avoid’.²⁷ At the same time it formalized the ‘best practices of surveillance’, developed through the years after the 1977 decision, emphasizing the importance of ‘dialogue, persuasion, candor, evenhandedness and due regard to country circumstances’ in investigations under Article IV.²⁸

Finally, the 2007 decision offered better definition to the concept of ‘exchange rate manipulation in order to gain unfair competitive advantage over other members’, relating such behavior to the concept of fundamental exchange rate misalignment. On this, the 2007 decision established that:

A member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund determined both that: (a) the member was manipulating its exchange rate or the international monetary system and (b) such manipulation was being carried out for one of the two purposes specifically identified in Article IV, Section 1(iii).

(a) “Manipulation” of the exchange rate is only carried out through policies that are targeted at—and actually affect—the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.

(b) A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken “in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an

²⁴ See the stark criticism by Morris Goldstein former Deputy Director of the IMF Research Department of the failure by the Fund to declare China a currency manipulator. See GOLDSTEIN, Morris, and WEATHERSTONE, Dennis, ‘Confronting Asset Bubbles, Too Big to Fail, and Beggar-thy-Neighbor Exchange Rate Policies’, Policy Brief 10-3, Peterson Institute, February 2010.

²⁵ IMF, above n 18.


²⁷ IMF, above n 18, at 1.

²⁸ Ibid.
undervalued exchange rate and (B) the purpose of securing such misalign-
ment is to increase net exports.  

Accordingly, the 2007 decision enhanced the surveillance over members’ exchange rate policies. Data from the IMF Staff show that less than two- thirds of Article IV Surveillance Reports included some kind of exchange rate analysis before the 2007 decision, while more than 90% did so in 2011.  

These analyses usually come in the form of exchange rate misalign-
ment estimates conducted by the Consultative Group on Exchange Rates (CGER).

The misalignment estimates were subject to much discussion and contro-
versy between members of the IMF and some of the estimates were not allowed to be published in their entirety. Many reports only mentioned vague references such as ‘substantially undervaluation or moderate under-
valuation’, without referring to an exact quantum. Also, this renewed atten-
tion to exchange rate misalignments did not prevent countries from tempering with the value of their currencies after the 2008 crisis in what has been referred to as a ‘currency war’.  

Some analysts argued that the focus was misplaced, with too much em-
phasis on the effects of exchange rate misalignment on domestic stability (national stability) as opposed to its effects on the stability of other members’ economies (global stability). Also, the exchange rate analysis suffered criti-
cism from some countries that considered the need for better analysis taking into account the integration between exchange rate and other national measure effects on overall economic health.  

The 2007 decision had already tried to address the effects of national measures, including exchange rate arrangements, to ‘external stability’ (i.e. other members’ economic stability). A new decision was drafted and adopted by the Executive Board of the IMF on 18 July 2012, addressing the issue—the Decision on Bilateral and Multilateral Surveillance, also known as the Integrated Surveillance Decision (ISD). The ISD com-
plemented the 2007 one and introduced rules ‘as a step toward modernizing the

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29 IMF, above n 24, at Annex I, para 2.  
33 According to the Public Information Notice of the IMF, the 2007 decision brought ‘a principle recommending that members avoid exchange rate policies that result in external instability, regardless of their purpose, thereby capturing exchange rate policies that have proven to be a major source of instability over the past decades’. See IMF, above n 18.  
foundations of Fund surveillance and part of a continuous effort to ensure that surveillance remains relevant and effective amidst the changing global economic landscape’.35

The IMF Strategy, Policy and Review Department along with the IMF Legal Department had produced a couple of policy papers and draft decision proposals called ‘Modernizing the Legal Framework for Surveillance’ indicating the need for updating the IMF legal framework in order to address the new economic issues being raised by its members, especially regarding the exchange rate misalignment issue and its effects on ‘global economic and financial stability’.36

Stability is the organizing principle of surveillance. Article IV consultations should focus on the appropriate conduct of economic and financial policies pursued by members to promote present and prospective domestic and balance of payments stability as well as global stability. For the latter, Article IV consultation reports should discuss potential or actual spillovers from members’ economic and financial policies that may significantly impact global stability, including alternative possible policy options that would minimize the adverse impact of spillovers on global stability. However, in the context of multilateral surveillance members will not be required to change their policies in the interest of global stability.37

In this sense, the ISD sought to address the challenges brought up by the financial crisis and by perceived global imbalances through a new perspective to be added to IMF’s surveillance exercises. Besides the national stability, the IMF will now focus on the spillovers of members’ exchange rate arrangements and other national measures on global stability, ‘bringing a multilateral perspective to surveillance’.38 Article IV Reports (bilateral surveillance) shall indicate possible consequences of members’ policies to global stability


36 See IMF, Modernizing the Legal Framework for Surveillance – Building Blocks toward an Integrated Surveillance Decision, prepared by the Strategy, Policy and Review Department and Legal Department, Approved by Siddharth Tiwari and Sean Hafan, IMF, 16 March 2012. See also IMF, above n 28.


38 Ibid, at 8. Para 23 of the ISD states that:

Beyond members’ obligations under Article IV Section 1, and recognizing that a member’s policies may have a significant impact on other members and on global economic and financial stability, members are encouraged to implement exchange rate and domestic economic and financial policies that, in themselves or in combination with the policies of other members, are conducive to the effective operation of the international monetary system.
and shall include ‘alternative possible policy options’ to minimize adverse impacts.

Two new surveillance mechanisms were created to enhance IMF’s surveillance strength. Countries’ obligations under Article IV of IMF’s Articles of Agreement would continue to be addressed through regular Article IV bilateral surveillance exercises, but a new mechanism of ‘firm surveillance’ has been created—Ad Hoc Article IV investigations. The IMF Managing Director may now call members to discuss specific exchange arrangements and policies that might violate their obligations under Article IV, section 1:

(a) Whenever the Managing Director considers that important economic or financial developments are likely to affect a member’s exchange rate policies or the behavior of the exchange rate of its currency, the Managing Director shall, in the context of the Fund’s exercise of firm surveillance over members’ exchange rate policies, initiate informally and confidentially a discussion with the member. After such discussion, the Managing Director may report to the Executive Board or informally advise the Executive Directors and, if the Executive Board considers it appropriate, an ad hoc Article IV consultation between the member and the Fund shall be conducted in accordance with the procedure set out in subparagraph (b) below.

(b) A staff report will be circulated to the Executive Directors under cover of a note from the Secretary specifying a tentative date for Executive Board discussion which will be at least 15 days later than the date upon which the report is circulated. The Secretary’s note will also set out a draft decision taking note of the staff report and completing the ad hoc consultation without discussion or approval of the views contained in the report; the decision will be adopted upon the expiration of the two-week period following the circulation of the staff report to the Executive Directors unless, within such period, there is a request from an Executive Director or decision of the Managing Director to place the report on the agenda of the Executive Board. If the staff report is placed on the agenda, the Executive Board will discuss the report and will reach conclusions which will be reflected in a summing up. 39

This mechanism is in addition to regular Article IV consultations and was conceived as a means to enhance surveillance over exchange rate policies that may be violating Article IV obligations. The second mechanism is the multi-lateral consultation initiative.

31. Whenever the Managing Director considers that an issue has arisen in a policy area of a member country that may significantly influence the effective operation of the international monetary system, and that requires collaboration among members that is not already effectively taking place in another forum in which the Fund is a party, the Managing Director shall

39 IMF, above n 32, para 28.
informally and confidentially discuss the issue with the relevant members. When the Managing Director forms the view that a multilateral consultation is necessary, the Managing Director may recommend such a consultation to the Executive Board, which may decide that a multilateral consultation will be held.

32. A multilateral consultation will consist of discussions between Fund staff and management and officials of relevant member countries, including, in the case of a currency union, with officials of relevant union-level institutions. The Fund will facilitate discussions among participating members and encourage them to agree on policy adjustments that will promote the effective operation of the international monetary system. In these discussions, the Fund will provide analysis and propose policy options that participating members may adopt, and may advise on the effect of different combinations of policy adjustments.40

Both mechanisms depend upon the active surveillance of the IMF Managing Director and its staff, significantly enhancing the weight and importance of their position. The Executive Board of the IMF was keen to guarantee the secrecy and souplesse of the mechanisms though, constantly reinforcing that they in no way meant an expansion of members’ obligations.41

Through both reforms, in 2007 and in 2012, the IMF, in its own way, tried to address the criticism it received regarding its lost grip over exchange rate arrangements and the issue of competitive devaluations. Although a lot has been achieved, and much still depends upon further developments of the new mechanisms, it is clear that the Fund has undeniably lost the firm control it had before the end of the dollar–gold standard. In place, several surveillance mechanisms have been created with the objective of stimulating countries to adopt policies that do not violate their obligations under Article IV of IMF’s Articles of Agreement.

As an international institution, the IMF had to adapt extremely fast to face the tremendous challenges imposed by the dynamic international economy so as to fulfill its duties. The Fund has found an important place in today’s international economic governance and managed to fulfill it accordingly during the last decades. In this sense, the end of the fixed exchange rate system and the fall of Article IV have not had as consequence the irrelevance of the Fund—as some had predicted at the time. The IMF has been able to adapt and evolve to these changes, but not without a deep overhaul of its system.

The main difficulties faced by the IMF come from its decision process, which is based in weighted votes, opened to blockages from the most powerful members. It lacks an enforcement mechanism as the Dispute Settlement Body of the WTO. In GATT language, ‘it has no teeth’.

40 Ibid, paras 31–32.
41 IMF, above n 34, at 2.
Nevertheless, however well the IMF system may have adapted, it did not find a way to preserve its link with the multilateral trading system, represented by the par value system. In reality, it lost this link, and the consequences of the fall of Article IV original strength, the end of a fixed exchange rate system and the gradual loosened control over exchange rate manipulations have been felt harder, presently, at the GATT/WTO system.

III. THE BREAKING OF THE EXCHANGE RATE LINK BETWEEN IMF AND WTO

When the GATT rules on international trade were conceived, the negotiators intended to constrain every unilateral measure by a country that would pose a threat to fair international trade. Rules were tailored to limit protectionist national measures to import tariffs. In this sense, these measures would be more clearly identified and easier to address.

During negotiations, a series of other national measures were analyzed and rules were created to deal with them. That was the case of the negative effects of subsidies and dumping on international trade flows. Additionally, the history of negotiations demonstrates an early concern with the impacts of two other kinds of ‘dumping’: the competitive exchange rate devaluations—‘currency dumping’ and the maintenance of low labor standards in order to acquire comparative advantages—‘social dumping’. Remedies were proposed to countervail such measures. 42 None of these mechanisms were present at the final Agreement.

The ‘social dumping’ was thought to be addressed gradually by the work of the UN system together with the International Labor Organization (ILO). The currency issue, however, seemed accordingly addressed under the Bretton Woods system. The fixed exchange rate system provided a strong safe-net against competitive exchange rate devaluations and their effects on trade. In this sense, the contracting parties had no reason to doubt the efficiency of such a system and established this link throughout the GATT. In the original GATT text, several passages can be found relating to the fixed exchange rate system. Articles II:6 and VI:4 are examples of mechanisms directly relating to par values established by the IMF.

However, in the minds of the founders of the post–World War II multilateral economic system, policy coherence and the consistency of rules was already an objective to be achieved, so several articles were inserted in the GATT reflecting in particular (1) the attachment of the trading community to exchange rate stability (2) and the need for the trading community to ensure that the rules-based trading system is not frustrated by the

42 See UN ECOSOC, E/PC/T/34 of 5 March 1947.
undisciplined use of multiple exchange rate arrangements or exchange restrictions.\textsuperscript{43}

Article XV is the main exponent of the bond between the two systems. It establishes the cooperation between the two organizations regarding exchange rate arrangements matters (Article XV:1). It also states that all contracting parties should seek membership at the IMF or, at least, enter in a special agreement with the CONTRACTING PARTIES (Article XV:6). Finally, it determines that ‘contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions’ of the IMF (Article XV:4). The relationship was in this sense tailored with the view that no exchange rate matters would ‘frustrate’ the intents of the GATT. This link was essential in order to neutralize the matter in GATT’s perspective.

The same logic was maintained even after the end of fixed exchange rate system. In order to adapt to the new reality of floating exchange rates and the revamped IMF Article IV, several decisions and guidelines were adopted by the CONTRACTING PARTIES to the GATT. An interesting example is that of Article II:6 which establishes the possibility of a country to renegotiate its specific bound tariffs after a 20\% devaluation of its currency. The renegotiation would only be possible if the devaluation occurred without violating the Fund’s rules and was based on the par value established.

After the fall of the par value system, the mechanism had to be adapted with the contracting parties issuing the\textit{ Guidelines for Decisions under Article II:6(a) of the General Agreement} (L/4938, 27S/28-29), on 29 January 1980, reaffirming the importance of the Fund’s evaluation of the country’s currency devaluation. The Working Group on Exchange Rate adopted the Guidelines establishing a process to be followed by parts facing the problem of undervalued currencies, allowing them to renegotiate their specific tariffs. This mechanism was invoked only 11 times, all of which occurred before the 1980 decision, and has since been buried in the archives of the WTO.

All adaptations followed the same pattern and relied upon the newly established ‘surveillance system’ created by the IMF. As it was shown in Part II of this article, the surveillance system also underwent several changes, adding other economic aspects that would be constantly analyzed by the Fund while loosening the control over exchange rate movements. In its appraisal, the Fund would consider exchange rate policies ‘within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member, and shall recognize that domestic as well as external

policies can contribute to timely adjustments of the balance of payments’. 44

The relative approach to exchange rate policies was well adapted to the
new role performed by the IMF after the end of the gold standard. It did
not, however, offer the same level of protection to the multilateral trading
system against the effects of exchange rate misalignments as it did in 1944.
More than that, the change in the Fund’s approach to exchange rate mis-
alignments meant a breaking of the protective link that justified the absence
of specific neutralizing mechanisms in the GATT/WTO system.

On the ability of the IMF’s new surveillance mechanism to exert control
over exchange rates. Lowenfeld argues that:

Article IV did not accomplish the objectives that the drafters had in mind.
Governments were reluctant to answer inquiries put by the Fund, and had
no real incentive to do so… The idea that the IMF, or the international
community through the IMF, could prescribe conduct under amended
Article IV comparable with what the Fund prescribed under Article V
did not prove viable, if indeed it was ever seriously considered. 45

Also, as some authors have argued, 46 the way IMF’s Article IV is presently
drafted, the proof of the intent of a member in manipulating its currency in
order to gain a ‘competitive advantage’ is a hard one to grasp, especially
taking into account the new role of the IMF and its surveillance mechanism.
Finally, even if the IMF were to recognize a member as a currency manipu-
lator, it lacks a dispute settlement mechanism or strong remedies to force a
member to change its exchange rate policy. 47

In practice, countries were now free to choose their exchange rate policies
(frequently through currency manipulation) as long as they did not peg their
currencies to the gold. The IMF would in turn seek the stability of the
system and provide financial support to countries facing balance of payment
difficulties. No similar adaptation was made, however, at the GATT level
even though it could no longer rely on the fixed system.

44 IMF, Principles of Fund Surveillance over Exchange Rate Policies – annex to the Executive Board
Decision 5392 (77/63), 29 April 1977.
45 LOWENFELD, above n 4, at 585.
46 See, inter alia, ZIMMERMANN, Claus D. ‘Exchange Rate Misalignment and International
Law’, 105(3) American Journal of International Law (2011), at 427–37. See also FUDGE,
Nathan, ‘Walter Mitty and the Dragon: An Analysis of the Possibility for WTO or IMF
Action against China’s Manipulation of the Yuan’, 45 (2) Journal of World Trade (2011),
at 349–73 and IRWIN, above n 5.
47 See GADBAW, R. Michael, ‘Systemic Regulation of Global Trade and Finance: A Tale of
Two Systems’, 13(3) Journal of International Economic Law (2010), at 551–574. This issue
was subject of a deeply enriching discussion held at the Institute of International Economic
Law (IIEF) Fellows Lunch meeting at Georgetown University, last January. The authors
would like to thank all the participants, and especially Prof. Michael Gadbaw, for the invalu-
able insights.
The GATT contracting parties, concerned with the negative effects of exchange rate fluctuations on international trade flows and acknowledging that ‘in certain circumstances exchange market instability contributes to market uncertainty for traders and investors and may lead to pressures for increased protection’, made a statement on 30 November 1984 urging the IMF to improve its system in order to take into account ‘the relationship between exchange market instability and international trade’.48

In response, the IMF published in 1984 a study describing the ways by which such exchange rate instability could affect international trade flows.49 The academic and empirical evidences were inconclusive and no systemic adjustments were made by the contracting parties to the GATT in order to address the uncertainty and potential negative effects of exchange rate fluctuations. Besides, no particular study was commissioned by the GATT on the impacts of exchange rate misalignments on the instruments of the multilateral trade system.

Concerns resurfaced during the financial crises of the late-1990s, when large currency devaluations by some crisis-hit countries, in certain cases under IMF programmes, provoked claims of “unfair trade” from import-sensitive sectors in some of their main trading partners and pressure for a trade policy response. Regular studies by the IMF helped reduce the gaps between facts and political perceptions, particularly in the immediate aftermath of large exchange rate movements; a new study on the relationship between exchange rates and trade by the IMF in 2004 updated the 1984 study. It concluded that while there was no compelling evidence that in the medium-run exchange rate fluctuations had a significant negative effective on the amount and direction of trade flows, it acknowledged the negative impact of prolonged misalignments of exchange rates, particularly in a regional context.50

Even after the creation of the WTO and the considerable enlargement of the multilateral trade system scope, the exchange rate issue was not incorporated into the Marrakesh Agreements. The Uruguay negotiation round focused on tackling non-tariff trade barriers that were becoming a much greater concern to international trade than the traditional tariff barriers. Even though the importance of a closer cooperation between the IMF and the WTO was highlighted in the resulting agreements (Declaration on the Relationship between the WTO with the IMF—Uruguay Round Declarations), and an agreement was done between the two institutions (WT/L/195), no specific

50 AUBOIN, above n 41, at 13.
mechanism was created to deal with exchange rate manipulations and misalignments.

The tensions that have arisen concerning the relationship between trade and exchange rate have been dealt with, since the 1970s, outside of the scope of either the IMF or the GATT/WTO, normally through political agreements between the concerned countries. The Plaza and the Louvre accord are important examples of such agreements that sought to rebalance depreciated or overvalued currencies causing diversion of trade flows.

In the present political landscape, however, such accords are harder to be reached. After the 2008 financial crisis and the political choice of some of the biggest economies to devaluate their currencies in order to stimulate economic recovery and growth, the problem has again arisen and the multilateral system has found itself unprepared to offer solutions.

The academy is not short of proposals for IMF/WTO cooperation on exchange rate issues, but the political will to tackle the issue seems very dim. In February 2013, the group comprising 20 major economies in the world (G20) met in the International Financial Architecture Working Group Meeting and produced a joint statement in which they declared the need to ‘refrain from competitive devaluation, from targeting the exchange rate for competitive purposes and to resist all forms of protectionism’. They did not, however, condemn monetary measures for domestic purposes that might, as a consequence, bear an impact on exchange rates. This has been interpreted as a silent endorsement of the measures undertaken by the USA, the EU, UK, and more recently Japan and is a signal that, at the present, there seems to be no political will to discuss the issue through the political channel of the G20.

Brazil has presented, to this date, three proposals of studying the subject at the WTO. Although contracting members have shown sympathy to the idea of analyzing the problem, the solution seeking is met with reserve and skepticism by many who consider that the IMF would be the appropriate forum for such a discussion.

The first submission of Brazil was presented to the Working Group on Trade, Debt and Finance (WGTDF) in April 2011, suggesting a work program consisting in an academic research on the relationship between exchange rates and international trade (WT/WGTDF/W/53). On 20 September 2011, Brazil presented its second proposal on the theme, suggesting the examination of available tools and trade remedies in the multilateral system that might allow countries to redress the effects of exchange rate misalignments (WT/WGTDF/W/56).

The WTO Secretariat presented its Note on a Review of Economic Literature on 27 September 2011 (WT/WGTDF/W/57), as mandated by

51 See, inter alia, the work done by HUFBAUER, Gary C. and SCHOTT, Jeffrey J., ‘Will the WTO Enjoy a Bright Future’, Policy Brief 12-11, Peterson Institute, May 2012.
the Working Group. It was an extensive research, but curiously it speaks the ‘language of the IMF’ and not ‘WTO language’. It did not touch the issue of the impacts of exchange rate misalignment on WTO principles, rules, and its instruments.

It is worth noticing that exchange rate devaluations have the same economic effects of horizontal subsidies, promoting exports while also inhibiting imports into the domestic market. The effects of exchange rate misalignments on tariffs have been discussed elsewhere, but also other trade instruments are potentially affected by exchange rate misalignments, such as: tariffs, antidumping, subsidies, safeguards, rules of origin, GATT Articles I, II, III, XXIV, just to name some of the rules that are certainly being affected by exchange rates.

Brazil’s third submission, of November 2012 (WT/WGTDF/W/68), brought up the discussion of the effects of exchange rate misalignments on such instruments as well as the possibility of exploring existing WTO rules to address such effects. It is yet soon to consider whether such initiative will stimulate WTO members to negotiate new trade rules that take into account the exchange rate issue.

IV. THE FORGOTTEN LEGAL LINK

Due to the historical and political developments commented above, many trade and finance experts believe that the exchange rate issue is one solely under the auspices of the IMF. The problem with that conception is that, although the contracting parties/members to the GATT/WTO did not negotiate new specific rules to deal with the new reality of floating exchange rates, the old GATT rules are still in place and have been incorporated into the WTO legal system.

GATT Article XV is thus still in force and offers a regulatory framework for dealing with exchange arrangements that might be affecting trade objectives. Albeit drafted in broad lines and not offering specific remedies, since it was conceived at a moment when the currency issue seemed accordingly neutralized, Article XV is the main legal link between the two systems. The big question is why it has remained unused by the contracting parties/members of the GATT/WTO?


54 One may also argue that, in a broader sense, Art. I of the IMF—which establishes the objectives of the Fund (especially its item ii)—read in conjunction with Article IV form another necessary legal link with the GATT, although one along even less defined lines.
This Article bears important features concerning the relationship between the IMF and the WTO systems, especially after the fall of the dollar-gold standard. The Article explicitly encourages WTO members to seek policy coordination on questions within the jurisdiction of the IMF that affect trade measures, recognizing the intrinsic relation between trade and finance. Concerning the specific issue of exchange rates and its impacts on trade, Article XV:4 states that:

Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.

An important question has been raised by the academy regarding the relationship between GATT Article XV and Article IV of IMF's Articles of Agreement and whether a violation of Article IV would be required in order to determine a violation of Article XV:4.

In order to answer these questions, one must look closely to the wording used in Article XV. Three different exchange terms are used throughout the Article, each bearing a specific meaning: exchange arrangements (Article XV:1); exchange action (Article XV:4); and exchange controls or restrictions (Article XV:9). The link between GATT Article XV and IMF Article IV is made obvious by their titles, each citing exchange arrangements as their subject of regulation. The use of the term exchange arrangements at the title of both articles seems to indicate it as a general expression, encompassing the different actions and mechanisms provided for in these articles.

Paragraph 2 of Article XV establishes that ‘in all cases’ involving exchange arrangements, the CONTRACTING PARTIES shall ‘consult fully’ with the IMF and that in such consultations they must ‘accept all findings of statistical and other facts presented by the Fund’ relating to this matter. Also, the CONTRACTING PARTIES ‘shall accept the determination of the Fund as to whether action by a contracting party in exchange matters’ is in accordance with the IMF’s Articles of Agreement.

Thus, in all cases in which Article XV is analyzed, the statistical findings (e.g. whether an exchange rate is misaligned) are presented by the Fund and


must be accepted as part of the facts at disposal for an objective assessment by the panel/Appellate Body. This is the case of findings concerning GATT Article XV:4 obligation. In order to analyze the ‘exchange action’ taken by a member that is allegedly frustrating the intent of the provisions of GATT, the CONTRACTING PARTIES must consult with the Fund and accept its statistical findings.

This does not mean, however, that the IMF will have a say whether a WTO member is in violation of Article XV:4 of GATT. The only judicial prerogative IMF has is on whether the exchange action is in accordance with the Fund’s own obligations. This is important to the application of the exception present at Article XV:9. It reads as follows:

9. Nothing in this Agreement shall preclude:
(a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party’s special exchange agreement with the CONTRACTING PARTIES, or
(b) the use by a contracting party of restrictions or controls in imports or exports, the sole effect of which, additional to the effects permitted under Articles XI, XII, XIII and XIV, is to make effective such exchange controls or exchange restrictions.

The rationale of this paragraph is to avoid the GATT mechanism of being contrary to the well-functioning of the IMF. One of the main goals of the IMF is to ensure the stability of balance of payments (Article I:iv) and the financial health of its members (Article I:i). In this sense, and in critical situations, the IMF allows for the exceptional use of capital controls and exchange restrictions throughout its Articles of Agreement.

Similar exceptions due to IMF mechanisms can be found in other GATT articles, e.g. Article VII:c on multiple currencies conversion; Ad Note to GATT Article VIII regarding exchange fees for balance of payment reasons; Article XIV:1,3 and 5(a) on exceptions to the Rule of Non-discrimination; Ad Note to Section B of GATT Article XVI on multiple exchange rates.

The member will be allowed to depart from a GATT rule in order to duly apply an IMF provision. In such cases, as determined by GATT Article XV:2, the final word on whether the member is correctly applying the IMF provision and thus not violating the GATT obligation, falls onto the IMF prerogative. Article XV:9 is an example of such case.

58 Regarding exchange controls and restrictions the following articles in the IMF’s Articles of Agreement can be cited: Art. VI s 3 control of capital transfers, Art. VII, s 3(b) and s 4 on control and restriction of exchange operations due to scarcity of currency; Art. VIII, s 2(b) on exchange control cooperation; Art. XIV, s 2 on exchange restrictions.
It is important to note, however, that GATT Article XV:9 makes clear reference to exchange controls or restrictions, while other GATT articles make direct reference to multiple exchange rates. These are the only exchange actions that are comprised in the exception. As noted above, these exact terms are found throughout the IMF’s Article of Agreements and indicate specific exchange actions. It is then plausible to argue that exchange actions, other than exchange restrictions or controls and multiple exchange rates, even when operated in accordance with the IMF Articles of Agreement, or, in contrario sensu, even in the absence of a formal IMF condemnation, can still frustrate the intent of the GATT provisions and thus contravene GATT Article XV:4.\textsuperscript{59}

This analysis is relevant in order to correctly differentiate between manipulators of exchange rate (IMF Article IV:3) and ‘frustrators’ of trade objectives (GATT Article XV:4). Although related, such notions bear important differences. As already stated, the proof of, and IMF’s political will to recognize, currency manipulation is complicated.\textsuperscript{60} One could still argue that any exchange rate manipulation ‘to gain an unfair competitive advantage’ over other countries will, if effective, frustrate trade objectives. The opposite is not necessarily true however. There may be other exchange actions that do not involve the specific action of exchange rate manipulation that can frustrate the intent of the GATT provisions.

In this sense, the legal discussion at the WTO could move away from the politically sensitive discussion of identifying currency manipulators and could focus on the analysis of the effects of exchange actions on trade instruments. The IMF would thus be consulted to provide statistical inputs on exchange rate misalignments, while the WTO experts would determine if exchange actions were frustrating the objectives of GATT articles.

It is important to stress though that even in the absence of an independent violation of a specific article of the GATT, the argument based on GATT Article XV:4 obligation would only require to demonstrate that the exchange action frustrated the ‘intent’ of the said provision. In other words, an exchange action can violate Article XV:4 even without violating completely the GATT mechanism whose intent has been frustrated—a rationale similar to the one present at GATT Article XXIII concerning non-violation.

In sum:

(a) IMF Article IV offers a legal basis for condemning currency manipulators, but its application is doubtful due to the subjectiveness of the

\textsuperscript{59} Miranda makes a similar argument in MIRANDA, above n 54, at 120.

\textsuperscript{60} See, ZIMMERMANN, Claus D. ‘Exchange Rate Misalignment and International Law’, 105 (3) American Journal of International Law, (2011), at 427–37, stating that the way Art. IV is drafted, it is improbable that one could prove the intent of a member in manipulating its currency in order to gain a ‘competitive advantage’.
‘intent’ condition and also due to the Fund’s new role in international economic governance.

(b) GATT Article XV focuses instead on searching for the ‘frustrators’ of trade objectives. Currency manipulators will, in most cases, frustrate trade objectives, but not all ‘frustrators’ are currency manipulators.

(c) The application of Article XV does not depend upon the determination by the IMF of which countries are currency manipulators—it is up to the WTO Dispute Settlement Body (DSB) to determine the frustration of GATT objectives.

(d) The WTO must consult and accept statistical inputs from the IMF regarding exchange arrangement issues and consider them as part of its objective analysis.

(e) Exchange actions can violate Article XV:4 even without violating completely the GATT mechanism whose intent has been frustrated—a rationale similar to the one present at GATT Article XXIII concerning non-violation.

(f) As an example—countries that maintain devalued currencies violate Article XV:4 (frustration), through the frustration of GATT Article II:1 intents (applied ad valorem tariffs above bound tariffs).

In the absence of new negotiated rules at the WTO to address specific aspects of the exchange rate and trade issue, Article XV remains as the forgotten legal link between the IMF and the WTO.

It should be rediscovered by WTO members even if only as a means to demonstrate the consequences of the missing link to international trade.

V. CONCLUSION

Criticisms of both the IMF and the WTO handling of the situation are growing between countries suffering the consequences of what has come to be recognized as a ‘currency war’. Many argue that the IMF, through Article IV surveillance mechanism, is the best institution to deal with the issue. But, for decades, IMF has done nothing to countervail the impacts of currency on trade instruments. WTO was left alone to handle this crucial issue because the link between trade and currency was lost in the fragmentation of Bretton Woods system.

The key problem is that the IMF has undergone a deep and meaningful ‘silent revolution’ that changed its fundamental role in the global economic governance framework. Its relationship and appreciation of the subject of exchange rates is nothing like what it was conceived for during the Bretton Woods negotiations. The Fund has no longer the control over members’ exchange rate values; neither does it have the intent to do so. Under its present agenda, the IMF considers exchange rates as one of the many macroeconomic variables it must oversee in order to guarantee national
and global economic stability. In this sense, manipulating or enduring a certain degree of exchange rate misalignment can be a valid tool in restructuring a country’s balance of payment. The strict impacts on trade are not under the scrutiny of IMF surveillance.

The multilateral trading system, however, still operates under the same presumption it had when the GATT was negotiated: that exchange rate movements were strictly controlled, neutralizing any possible harmful effects on trade instruments. The same legal structure remains unaltered. The multilateral trading system fails to acknowledge that such a link is now gone, bearing substantial and horizontal impacts for all its rules.

Although technically the legal basis for an IMF control over competitive currency devaluations is still present in the organization’s Articles of Agreement, the evolution of its role in the international economic governance demonstrates that it is hardly conceivable that the Fund would do it, at least not in the way the WTO mechanisms would require in order to neutralize the misalignment effects on trade instruments.

The recent amendments to the Fund’s rules and practices regarding Article IV surveillance mechanism indicate that the institution is seeking to address the issue under its own logic. No reference is made, though, to ways of addressing the effects of exchange rate misalignments on trade rules. Also, no reference is made to cooperation between the IMF and the WTO in cases where ‘important economic or financial developments are likely to affect a member’s exchange rate policies’.61

It seems very unlikely that the international monetary system is going back to the hard control over exchange rate variation similar to the one in place during the dollar–gold standard. In this sense, the rules of the multilateral trading system must adapt to this new reality, taking into account the effects of exchange rate misalignments on its mechanisms. Continuing to ignore the fundamental shift in the international monetary system will only postpone a serious problem and endanger the trade system to economic irrelevance.

The signs are already there, as the present ‘currency war’ has been pushing countries to take an ever growing protectionist and defensive position. As Irwin warned in 2011:

Left unresolved, these tensions over exchange rate policy could give rise to unilateral action. This would not only undermine the credibility of the international institutions that have responsibility in this area, but could lead to damaging retaliation that would be difficult to contain and further harm a weakened world economy. The solution is for the international community, in particular the IMF and the WTO, to work out new rules to help defuse current and future disputes over exchange rate policy and

61 IMF, above n 32.
clarify the conditions under which trade sanctions might be considered an appropriate remedy.\textsuperscript{62}

While diplomats and experts discuss how to deal with the problem, there is already clear evidence that exchange rate misalignments are destroying many of the trade instruments. As was shown by Thorstensen, Marçal, and Lucas,\textsuperscript{63} overvalued currencies can nullify applied and bound tariffs negotiated in past Rounds. On the other hand, undervalued exchange rates are not only granting subsidies to exports, but also raising import tariffs above the levels negotiated at the WTO, in clear violation of GATT Article VI and Article II. The evidence is so strong that the efficacy of all trade defense instruments, as antidumping, antisubsidy, and safeguard, can be put in jeopardy.

There are two approaches being discussed in the academic world. One is looking for the manipulators of IMF Article IV, as the work of Joseph Gagnon from the Peterson Institute in Washington, who seeks a solution inside the IMF, but also proposes trade tariffs as a possible way of enforcing good behavior from distorting members.\textsuperscript{64} More recently, Fred Bergsten and Joseph Gagnon published another article in which they name Switzerland, Japan, Israel, Singapore, China, Malaysia, Thailand, and oil exporters as currency manipulators.\textsuperscript{65}

This proposal tries to develop a methodology based on IMF Article IV concept of manipulation of exchange rates and is based on the magnitude of reserves, current account, and currency misalignments. He names Switzerland, Japan, Israel, Singapore, China, Malaysia, Thailand, and oil exporters as currency manipulators and defines manipulation of currencies as the result of government pushing down the currency value through official financial flows (government spending, tax rates, and money creation through interest rate) or manipulation through capital control measures such as taxes or regulatory restrictions. This approach is done under the logic of the IMF.

The second approach is to look for the ‘frustrators’ of the objectives of the WTO Agreements, as established by GATT Article XV. The idea is to create a mechanism inside the WTO that neutralize the effects of exchange rate misalignments on the existing trade instruments as correction of tariffs, or the introduction of an exchange rate misalignments clause in antidumping, antisubsidies, or safeguards instruments. This mechanism should follow all the GATT traditional rituals: investigation, temporality, and application on a sectorial basis, since the effects of misalignments are different among sectors.

\textsuperscript{62} IRWIN, above n 5, at 33.
\textsuperscript{63} THORSENSEN et al., above n 50.
\textsuperscript{65} See BERGSTEN and GAGNON, Fred above n 1.
One example of a correcting mechanism through antisubsidies is proposed by Lima-Campos and Gil.66

The effects of exchange rate misalignment are so devastating that a solution to the problem must be sought immediately, without waiting for a new Round as proposed by some cautious minds.

The multilateral trading system community cannot wait for the endless and inconclusive discussions of economists that are always looking for the myth that ‘at the long range, equilibrium will be reached’. The concept of time for economists is not the same as for jurists. There is no such a thing as violating a rule until a solution is reached in the long run. It seems as there is also a missing link between economists and lawyers. They must work together to guarantee that the WTO maintains its indispensable role as a guarantor of international fair trade.

In the absence of new negotiated rules at the WTO to address specific aspects of the exchange rate and trade issue, Article XV remains the only possible legal link between the IMF and the WTO. It is a forgotten link, but it must be revived and improved.

As cases of trade frustrations multiply, members will feel more tempted to test its applicability through the WTO Dispute Settlement System, by exploring Article XV limits, and this delicate and utmost important issue will be left, again, to be resolved by the Appellate Body of the WTO.

The most urgent task of the WTO in these convoluted times is to look for the missing exchange rate link between the WTO and the IMF, lost in the last decades, and rescue it from the archives of the international organization’s history.

Either this link is reconstructed or the WTO and the IMF will ultimately fail in their mission as relevant international institutions for effective global economic governance.