

1-1-2007

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### Recommended Citation

Goldburn, Tricia D. (2007) "Dollars & Renminbis: Curbing the United States' Raging Trade Deficit with China by Dismantling the Dollar-Rmb Peg," *Penn State International Law Review*: Vol. 25: No. 3, Article 6.  
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# Dollars & Renminbis: Curbing the United States' Raging Trade Deficit with China by Dismantling the Dollar-Rmb Peg

Tricia D. Goldburn\*

## I. The Surging U.S. Trade Imbalance with China

The U.S.-China trade deficit<sup>1</sup> has exploded. Between 1985 and November 2006,<sup>2</sup> the U.S. Department of Commerce reported that the bilateral deficit soared from a negligible \$6 million to an unprecedented \$213.6 billion.<sup>3</sup> Currently, America's most lopsided trade shortfall is with China.<sup>4</sup> Propelling the disparity is that over the same time period, Chinese imports into the United States steadily exceeded American exports to the Asian country by more than \$1.2 trillion.<sup>5</sup> In 2006 alone, Chinese goods totaled \$263.6 billion of the \$1.7 trillion cumulative U.S. imports, while American goods to China amounted to a mere \$50 billion of the \$947.9 billion aggregate U.S. exports.<sup>6</sup> China is the United States'

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1. Unless noted otherwise, the discussion in this Comment refers exclusively to the goods trade between the United States and China on a U.S. Census basis. Research for this Comment concluded on January 30, 2006, except to update statistical information from the U.S. Department of Commerce.

2. Data for November 2006 is the most recent information currently available from the U.S. Department of Commerce. All references to 2006 are up to that period.

3. Trade in Goods (Imports, Exports and Trade Balance) with China, <http://www.census.gov/foreign-trade/balance/c5700.html#2006> (last visited Jan. 20, 2007) [hereinafter Trade in Goods]. In 1985, the cumulative American exports numbered \$3,855.7 million while Chinese imports measured \$3,861.7 million. As of November 2006, the aggregate Chinese imports grew to \$263.6 billion, but American exports increased to only \$50 billion. *Id.* (Calculations may be slightly off due to rounding.)

4. See Top Trading Partners—Total Trade, Exports, Imports, November 2006, <http://www.census.gov/foreign-trade/statistics/highlights/toppartners.html> (last visited Jan. 20, 2007) [hereinafter Top Trading Partners]. As of November 2006, China replaced Mexico as the United States' second largest trading partner. *Id.*

5. See Trade in Goods, *supra* note 3. The number of imports exceeded that of American exports for each year during that time span. *Id.*

6. Top Trading Partners, *supra* note 4. Trade with China measured 11.8% of total U.S. trade. *Id.*

second largest trading partner; its second-ranked source for imports; and its fourth biggest export market.<sup>7</sup>

Undoubtedly, the United States benefits from its trade relationship with China. Official capital inflow (investments in American assets by foreign governments)<sup>8</sup> from the Asian nation, due to China's seemingly insatiable appetite for American assets, helps to keep U.S. interest rates low.<sup>9</sup> Likewise, substantial official capital inflow—primarily used to purchase U.S. treasury and agency securities<sup>10</sup>—subsidizes the rapidly accelerating federal budget deficit and retards the adverse effects of declining personal-savings rates.<sup>11</sup> The massive incursion of Chinese imports into the U.S. markets<sup>12</sup> results in more choices and lower prices for American consumers,<sup>13</sup> thereby increasing their real income<sup>14</sup> and strengthening their purchasing power.<sup>15</sup> Because consumption and not production often reflects the economic wellbeing of a State,<sup>16</sup> the bolstered position of the American consumer perpetuates the notion of a robust U.S. economy.

In spite of those benefits, the news is not wholly optimistic. China's practice of affixing its currency, the renminbi<sup>17</sup> ("Rmb"), to the U.S. dollar creates an unfair competitive advantage for the Asian country.<sup>18</sup>

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7. *Id.* Canada leads China as the United States' largest trading partner and import market. Canada, Mexico, and Japan rank higher than China for exports. *Id.*

8. Marc Labonte & Gail Makinen, CRS Report for Congress, *Changing Causes of the U.S. Trade Deficit*, at 1 (2005).

9. Wayne M. Morrison & Marc Labonte, CRS Report for Congress, *China's Currency Peg: A Summary of the Economic Issues*, at 4 (2005).

10. See Leslie P. Norton, *What's Behind the Debate Over China's Currency*, BARRON'S, July 28, 2003, at MW8.

11. Morrison & Labonte, *supra* note 9, at 4-5.

12. In 2005, imports from China accounted for more than three-quarters of the imported consumer goods. Christopher L. Bach, *U.S. International Transactions in 2005*, at 31-32 (Apr. 2006), [http://www.bea.gov/bea/ARTICLES/2006/04April/0406\\_ITA.pdf](http://www.bea.gov/bea/ARTICLES/2006/04April/0406_ITA.pdf) (last visited Jan. 20, 2007).

13. Bill Thomas, Chairman, House Committee on Ways & Means, *U.S. Trade Deficit with China: An Economy-Wide View* (Apr. 2005), <http://waysandmeans.house.gov/media/pdf/trade/chinatradedeficit.pdf> (last visited Jan. 20, 2007).

14. *Id.*

15. Morrison & Labonte, *supra* note 9, at 4.

16. *Id.*

17. The official People's currency is the renminbi ("Rmb"), and the yuan is its unit of account. Rmb refers to China's currency as in the U.S. dollar. Yuan refers to amounts (as in \$5) or circulating notes (for instance, a \$10 bill). Many economists and financial analysts use the words interchangeably. Joint Economic Committee, *PRC's Pegged Exchange Rate Contributes to Global Imbalances*, at 26 n.1 (2005), [www.house.gov/jec/publications/109/prc05-25-05.pdf](http://www.house.gov/jec/publications/109/prc05-25-05.pdf) (last visited Jan. 20, 2007) [hereinafter *PRC's Pegged Exchange*].

18. Jonathan E. Sanford, CRS Report for Congress, *China's Currency: Brief Overview of U.S. Options*, at 2 (2005).

Since January 1994, the People's Bank of China ("People's Bank" or "PBOC") has maintained a relatively immobile exchange rate between the two currencies.<sup>19</sup> Consequently, the Rmb's value is lower than it would be if it were determined by supply and demand or freely floated on the global currency market.<sup>20</sup> A result of that practice is that Chinese exports enter international markets at significantly low prices,<sup>21</sup> while foreign imports, including American goods, enter China's domestic markets at much higher costs.<sup>22</sup> In light of that outcome and other economic concerns, the U.S. must regain control of its trade deficit with China. As a first step, the United States should act to disband the currency arrangement implemented by the People's Bank.

This Comment advocates challenging the currency peg before the Dispute Resolution Panel of the World Trade Organization ("WTO"). Part II presents an historical synopsis of the trade relationship between the countries. Part III explains the nexus between the two currencies and highlights some of the economic consequences that the currency arrangement has on the two countries. Part IV discusses the U.S. reaction to the currency arrangement. Part V explores proposals that have been proffered for dealing with the peg and investigates the potential consequence of each; the section culminates with the course of action that the U.S. should pursue. The resolution sought from the WTO enables an equitable arrangement between the two currencies. It allows China to conform to certain obligations under international protocols, namely those of the WTO and the International Monetary Fund. Finally, the resolution, acknowledging the economic repercussions of an upward revaluation of the Rmb, strives for an outcome that protects both the U.S. and Chinese economies. Part VI concludes the Comment.

Although, this Comment strongly advocates revaluing the Rmb as an immediate solution to the U.S.-China trade deficit, it does not imply that a revalued Rmb is the exclusive remedy. The bilateral trade imbalance is attributable to several causes. This Comment asserts that the relationship between the two currencies is the chief agitator. Accordingly, if U.S. officials are genuinely motivated to correct the lopsided trade deficit with China, they must first act to dislodge the dollar-Rmb peg.

## II. The Evolution of the Sino-American Trade Relationship

The United States and China share a lengthy trading history. That

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19. *PRC's Pegged Exchange*, *supra* note 17, at 27 n.11.

20. Morrison & Labonte, *supra* note 9, at 3.

21. *See id.* at 2.

22. *Id.*

relationship, however, is rarely without controversy. For a time, it was nonexistent due to China's embrace of communist philosophy. In spite of that allegiance persisting, the countries' trade partnership has grown steadily since its resumption in the early 1980s.

#### A. *Normal Trade Relations*

Before 1951, the U.S. conducted trade with China pursuant to a statutory grant.<sup>23</sup> The Reciprocal Trade Agreements Act of 1934,<sup>24</sup> sought to liberalize U.S. trade<sup>25</sup> by authorizing the president to negotiate bilateral agreements with foreign nations.<sup>26</sup> Those agreements alleviated duties and other import restrictions,<sup>27</sup> and elevated the United States' trading partners to most-favored nation<sup>28</sup> or normal trade relations ("NTR")<sup>29</sup> status. China maintained that standing with the U.S. until September 1, 1951, when President Harry S Truman revoked it.<sup>30</sup> In accordance with the newly enacted Section 5 of the Trade Agreements Extension Act of 1951,<sup>31</sup> President Truman suspended all trade with the Soviet Union and a majority<sup>32</sup> of the Sino-Soviet bloc regions<sup>33</sup> and countries,<sup>34</sup> including China.<sup>35</sup> It was not until February 1, 1980 that the two countries resumed their trade relationship.<sup>36</sup> At that time, China remained a nonmarket economy;<sup>37</sup> therefore, its NTR standing could

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23. Vladimir N. Pregelj, CRS Report for Congress, *Most-Favored-Nation Status of the People's Republic of China*, at 1 (2001).

24. 19 U.S.C. § 2136 (1998).

25. See generally *id.*

26. Pregelj, *supra* note 23, at 2-3.

27. 19 U.S.C. § 2136 (1998).

28. Vladimir N. Pregelj, CRS Report for Congress, *Normal-Trade-Relations (Most-Favored-Nation) Policy of the United States*, at What is Normal-Trade-Relations (Most-Favored-Nation) Treatment? (2000).

29. In 1998, Congress officially changed the designation of most-favored nation to normal trade relations to refer to nondiscriminatory tariff treatment. 19 U.S.C. § 2481(9) (1998).

30. Pregelj, *supra* note 23, at 1.

31. Pregelj, *supra* note 28, at U.S. Most-Favored-Nation Policy.

32. Yugoslavia's NTR status was not withdrawn. However, countries and regions that lost NTR standing included: Albania, Bulgaria, China, Cuba, Czechoslovakia, Estonia, Germany, Hungary, Indochina (communist dominated areas of Cambodia, Laos, and Vietnam), Korea, Kurile Islands, Latvia, Lithuania, Outer Mongolia, Poland and its communist-controlled areas (which was restored in 1960), Rumania, Southern Sakhalin Island, Soviet Union, Tanna Tuva, and Tibet. Pregelj, *supra* note 28, at U.S. Most-Favored-Nation Policy.

33. *Id.*

34. Pregelj, *supra* note 23, at 1.

35. Pregelj, *supra* note 28, at U.S. Most-Favored-Nation Policy.

36. See Wayne M. Morrison, CRS Report for Congress, *China-U.S. Trade Issues*, at The Relationship Between China's NTR Status and WTO Accession (2001).

37. "In general[,] the term 'nonmarket economy country' means any foreign country

only be reinstated pursuant to Title IV of the Trade Act of 1974 (“1974 Act”).<sup>38</sup>

The 1974 Act restored China’s NTR status temporarily and contingent upon certain renewal provisions.<sup>39</sup> The first of those conditions was an agreement between the two countries stipulating mutual and nondiscriminatory tariff treatment.<sup>40</sup> Initially, the renewed NTR extended for three years.<sup>41</sup> Thereafter, it was renewable triennially<sup>42</sup> if the president ensured that “a satisfactory balance of concessions in trade and services [had] been maintained during the life of [the] agreement, and . . . that actual or foreseeable reductions in [U.S.] tariff and nontariff barriers to trade resulting from multilateral negotiations [were] satisfactorily reciprocated by [China].”<sup>43</sup> Congress retained its authority to reject, by joint resolution, the initial agreement and any subsequent extensions.<sup>44</sup>

The second provision of NTR restoration required China’s compliance with the freedom of emigration mandate<sup>45</sup> of the so-called Jackson-Vanik Amendment (“J-V Amendment”).<sup>46</sup> Under the 1974 Act, however, the president could waive that requirement by executive order.<sup>47</sup> To do so, the president must report to Congress that such a waiver substantially promoted the J-V Amendment’s objectives, and China’s emigration policies did not contravene the purpose of the J-V Amendment.<sup>48</sup> As with the underlying trade agreement, the second stipulation was renewable subject to congressional approval.<sup>49</sup> Subsequent extensions though were granted on an annual basis.<sup>50</sup>

For the most part, China’s NTR standing remained unchallenged until 1989.<sup>51</sup> After the Tiananmen Square tragedy,<sup>52</sup> several members of Congress sought on repeated occasions to tie China’s NTR status to the

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that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.” 19 U.S.C. § 1677(18)(A) (1996).

38. Pregelj, *supra* note 23, at 1; *see generally* 19 U.S.C. 2431 (1975).

39. Pregelj, *supra* note 23, at 1.

40. 19 U.S.C. § 2435(a) (1990).

41. 19 U.S.C. § 2435(b)(1) (1990).

42. *Id.*

43. *Id.*

44. *Id.*; *see also* 19 U.S.C. § 2435(c) (1990).

45. Pregelj, *supra* note 23, at 2.

46. 19 U.S.C. § 2432 (1998).

47. 19 U.S.C. § 2432(c) (1998).

48. 19 U.S.C. § 2432(c)(1) (1998).

49. 19 U.S.C. § 2432(d)(1)(c) (1998).

50. 19 U.S.C. § 2432(d)(1) (1998).

51. Morrison, *supra* note 36, at The Relationship Between China’s NTR Status and WTO Accession.

52. *Id.*

country's human rights record, weapons proliferation, Taiwan security, and protection of intellectual property rights.<sup>53</sup> None of those efforts, however, was successful.<sup>54</sup>

*B. Permanent Normal Trade Relations*

On November 15, 1999, the two countries entered into a new agreement ("1999 Agreement").<sup>55</sup> Under that accord, China conceded to eliminating trade barriers on services, agriculture, and industry goods<sup>56</sup> in exchange for President William J. Clinton's advocacy for permanent NTR ("PNTR") and World Trade Organization ("WTO") membership.<sup>57</sup> President Clinton, along with other supporters of PNTR legislation, urged that PNTR with China was critical to American interests.<sup>58</sup> They proffered that without PNTR status if the Asian nation were admitted to the WTO, U.S. firms would not benefit from the trade concessions made in China's accession agreement.<sup>59</sup> Moreover, PNTR would make the Chinese domestic markets more accessible to American companies,<sup>60</sup> and the United States could avail itself of the WTO's dispute resolution procedure to settle trade disagreements that may arise between the two nations.<sup>61</sup> Opposition against the PNTR legislation cited the 1999 Agreement's failure to prevent low-cost Chinese goods from inundating U.S. markets<sup>62</sup> and injuring the domestic labor force.<sup>63</sup>

Despite the opposition, legislation granting China PNTR status was enacted in October 2000<sup>64</sup> with specific safeguards to allay some of the concerns raised.<sup>65</sup> Congress established a commission to monitor and report trends in China's policies that were threatening to U.S. interests.<sup>66</sup> An allowance to implement anti-surge mechanisms should the U.S.

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53. *Id.*

54. *Id.*

55. Sean D. Murphy, ed., *U.S. Enacts Law on Normalizing Trade Relations with China*, 95 AM. J. OF INT'L L. 145, 145 (No. 1 2001).

56. Wayne M. Morrison, CRS Report for Congress, *China and the World Trade Organization*, at Summary (2001).

57. Murphy, *supra* note 55, at 145. If China were granted PNTR status, the country would no longer be required to submit to the trade renewal procedures of Title IV of the Trade Act of 1974. Pregelj, *supra* note 23, at 12.

58. Morrison, *supra* note 36, at The Relationship Between China's NTR Status and WTO Accession.

59. *Id.*

60. *Id.*

61. *Id.*

62. Murphy, *supra* note 55, at 146.

63. *Id.*

64. *Id.*; see also 114 Stat. 881 (2000).

65. 114 Stat. 881 (2000).

66. 22 U.S.C. § 7002 (2005).

determine that disruptions in its domestic markets would result from a deluge of Chinese imports was also included.<sup>67</sup> Moreover, the president was required to certify to Congress that any compact executed with China promoting that country's accession to the WTO would embody the terms and conditions of the 1999 Agreement.<sup>68</sup> Finally, China's PNTR status became effective only if the Asian nation were accepted into the WTO.<sup>69</sup>

### C. *World Trade Organization Partners*

After fifteen years of intense negotiations, the WTO admitted China on December 11, 2001.<sup>70</sup> The new WTO standing was important to the Asian nation for several reasons. First, it guaranteed China PNTR status with the U.S.<sup>71</sup> Second, membership acknowledged that the Asian nation was an emerging economic giant around the world.<sup>72</sup> Third, the Chinese government could participate in the creation of any new trade rules governing WTO trading partners.<sup>73</sup> Fourth, membership allowed China to avail itself of the WTO's dispute resolution process, which eliminated exposure to threats of import restrictions against Chinese exports.<sup>74</sup>

Similarly, China's acceptance into the WTO was advantageous for its existing and new trading partners. Like all other members of the international body, China had to disclose the intricacies of its trade regime to the WTO's Working Party.<sup>75</sup> Member states desiring access to China's domestic market could negotiate, freely and independently, bilateral agreements for trade concessions and commitments.<sup>76</sup> In addition to those individual accords, China had to come to terms with the WTO's Working Party regarding the rules that were to govern the country's trade practices.<sup>77</sup>

The U.S. grant of PNTR status was the principal indicator of the American position regarding China's WTO accession.<sup>78</sup> Trade analysts

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67. Murphy, *supra* note 55, at 146.

68. 114 Stat. 881 (2000).

69. *Id.*

70. Office of the United States Trade Representative, *Background Information on China's Accession to the World Trade Organization*, (Dec. 11, 2001), [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2001/Section\\_Index.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2001/Section_Index.html) (last visited Jan. 20, 2007) [hereinafter *China's Accession to the WTO*].

71. Morrison, *supra* note 56, at China's Interest in WTO Membership.

72. *Id.*

73. *Id.*

74. *Id.*

75. *China's Accession to the WTO*, *supra* note 70.

76. *Id.*

77. *Id.*

78. Morrison, *supra* note 56, at The Role and Interest of the United States.



in the United States posited that the Asian country's rapidly expanding economy was a promising market for a variety of American exports.<sup>79</sup> The U.S. used its prominent role in the WTO to assist in China's accession premised upon America's understanding that membership would suppress Chinese restrictions on imports into its domestic market; it would open the Asian nation's trade regime to international scrutiny; and it would afford foreign companies the same treatment as their Chinese counterparts.<sup>80</sup>

#### *D. The Character of the Goods Traded*

The nature of the goods traded between the two countries is very distinct. United States' imports from China comprise inexpensive consumer products, such as low-priced apparel and footwear, toys, sporting equipment, and consumer electronics.<sup>81</sup> China, on the other hand, imports more expensive and technologically advanced American products, including aircraft and transportation equipment, pharmaceuticals, medical devices, semiconductors, and computer software.<sup>82</sup> Several major U.S. corporations<sup>83</sup> invest in China by relocating their manufacturing or research and development operations<sup>84</sup> to take advantage of the low-cost Chinese workforce.<sup>85</sup> Presently, the U.S. is China's third largest foreign direct investor, ranking only behind Hong Kong and Taiwan.<sup>86</sup>

The composition of the goods exchange encourages proponents of continued trade to reject concerns about the bilateral trade deficit.<sup>87</sup> They assert that Chinese exports do not replace goods commonly manufactured in the U.S.<sup>88</sup> In fact, ninety percent of the Chinese products imported into the U.S. directly substitutes goods from other

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79. *Id.*

80. *Id.*

81. Businessroundtable.org, The U.S. Bilateral Trade Deficit with China is not a Sign of U.S. Economic Weakness, [http://trade.businessroundtable.org/trade\\_2005/china/trade\\_deficit.html](http://trade.businessroundtable.org/trade_2005/china/trade_deficit.html) (last visited Jan. 20, 2007).

82. *Id.*

83. Corporations include the Ford Motor Company, General Electric, and General Motors among others. See Morrison, *supra* note 36, at China's Economy.

84. U.S.-China Economic and Security Review Commission, *U.S.-China Commission Cites Troubling Trends for U.S. Economic and National Security Interest. Details Year-Long Studies and Offers Numerous Recommendations in Annual Report to Congress*, (Jun. 15, 2004), <http://www.uscc.gov> (last visited Jan. 20, 2007).

85. See Morrison & Labonte, *supra* note 9, at 6.

86. Morrison, *supra* note 36, at China's Economy.

87. See generally Businessroundtable.org, *supra* note 81.

88. The U.S.-China Business Council, *Understanding the U.S.-China Balance of Trade*, (Aug. 3, 2004), <http://www.uschina.org/statistics/2004balanceoftrade.html> (last visited Jan. 20, 2007) [hereinafter *U.S.-China Balance of Trade*].

low-wage Eastern and Southeastern Asian economies.<sup>89</sup> Their criticisms also cite deficiencies in the U.S. Department of Commerce's method of calculating the imbalance. Firstly, they contend that exclusion of the entrepôt trade<sup>90</sup> through Hong Kong deflates the amount of U.S. exports to China by as much as thirteen percent.<sup>91</sup> Secondly, the reported imbalance does not account for costs related to freight, insurance, and loading.<sup>92</sup> Accordingly, if those costs were incorporated, the value of U.S. exports would increase by one percent and imports would decrease by as much as ten percent.<sup>93</sup>

More importantly, the supporters proffer that the trade deficit is indicative of the strength of the American consumers' purchasing power relative to the purchasing power of their Chinese counterparts.<sup>94</sup> Hence, the correlation between the bilateral trade deficit and U.S. economic growth should be considered a benefit.<sup>95</sup> That is to say, a decline in the deficit would slow the United States' economy and vice versa.<sup>96</sup> As evidence of those assertions, proponents point to the U.S.' trade deficits with Canada and Mexico despite America's unbridled access to those markets created by the North American Free Trade Agreement.<sup>97</sup> Other economic analysts,<sup>98</sup> however, caution that the trend in the deficit should be of concern because it is symptomatic of China's restrictive trade and investment practices.<sup>99</sup>

### III. China's Managed-Currency Regime<sup>100</sup>

The People's Bank issues and controls the Rmb exclusively;<sup>101</sup> it determines the currency's exchange rate, which the State Administration of Exchange Control supervises, under direct governance of the

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89. *Id.*

90. Entrepôt trade means goods shipped from one economy to another via a third-party economy after additional processing or assembly. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. See Businessroundtable.org, *supra* note 81.

95. See generally *id.*

96. See *id.*

97. *Id.*

98. Morrison, *supra* note 36, at Summary.

99. *Id.*

100. See Edmund L. Andrews, *China's Currency Shift: In Washington; China Floats Free From the Dollar*, N.Y. TIMES, July 22, 2005, at C1. See also International Monetary Fund, *De Facto Classification of Exchange Rate Regimes and Monetary Policy Framework*, <http://www.imf.org/external/np/mfd/er/2005/eng/1205.htm> (last visited Jan. 27, 2007) (classifying the People's Bank currency exchange rate regime as a currency board arrangement).

101. China.org.cn, *The Renminbi and Foreign Exchange Rate Control*, <http://www.china.org.cn/english/features/38255.htm> (last visited Jan. 27, 2007).

PBOC.<sup>102</sup> In 1974, the Rmb's exchange rate was pegged to an undisclosed fifteen-currency basket against which its daily value remained static.<sup>103</sup> The People's Bank, however, abandoned that scheme in the early 1980s.<sup>104</sup> Over the years, the exchange rate regime underwent a series of modifications,<sup>105</sup> including a divergence of the official exchange and market swap rates.<sup>106</sup> In January 1994, the PBOC unified the dual-rate scheme and affixed it to the U.S. dollar.<sup>107</sup>

#### A. *The Anatomy of the Dollar-Rmb Peg*

To maintain the dollar-Rmb peg, the People's Bank established a reference exchange rate between the two currencies.<sup>108</sup> At its institution, that rate was about 8.28 Rmb to the U.S. dollar.<sup>109</sup> Additionally, the PBOC created a trading band of approximately 0.3% within which the reference exchange rate would vacillate.<sup>110</sup> Consequently, on any given trading day, the Rmb's value (8.28 to the dollar) would not increase or decrease more than 0.3% against the value of the dollar.<sup>111</sup>

Sustaining the peg required that the People's Bank trade a sufficient amount of U.S. dollars to prevent the Rmb from accumulating against the dollar and vice versa.<sup>112</sup> That aggregation and alienation of the American currency anchored the reference exchange rate despite changing economic factors that would normally cause the Rmb's value to fluctuate if the currency were floated.<sup>113</sup> At the installation of the fixed exchange rate, the Rmb's value was nearly equivalent to its actual market value; in recent years, however, changes in economic conditions would have caused the currency's value to appreciate if it were determined by the

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102. *Id.*; see also International Economics, *Historical Exchange Rate Regime of Asian Countries*, [http://intl.econ.cuhk.edu.hk/exchange\\_rate\\_regime/index.php?cid=8](http://intl.econ.cuhk.edu.hk/exchange_rate_regime/index.php?cid=8) (last visited Jan. 27, 2007) [hereinafter *Historical Exchange Rate*].

103. *Historical Exchange Rate*, *supra* note 102 (citing the World Currency Yearbook, 1986-1987, 171).

104. *Id.*

105. *Id.*

106. *Id.*; see also Morrison & Labonte, *supra* note 9, at 1 n.1. Market swap rate is used primarily for trade transactions. Morrison & Labonte, *supra* note 9, at 1 n.1.

107. *Historical Exchange Rate*, *supra* note 102. See also Morrison & Labonte, *supra* note 9, at 1 n.1. Prior to reunification, the official exchange rate was approximately 5.8 yuan to the dollar and market swap rate was 8.7 yuan to the dollar. Morrison & Labonte, *supra* note 9, at 1 n.1.

108. Morrison & Labonte, *supra* note 9, at 1.

109. *Id.*

110. *Id.*

111. Keith Bradsher, *China Loosens Limits on Trading Against Other Currencies but Keeps Rein on Dollar*, N.Y. TIMES, Sept. 24, 2005, at C6.

112. Morrison & Labonte, *supra* note 9, at 1.

113. *Id.*

global market.<sup>114</sup>

### 1. How Other Countries React to the Peg

The peg influences the Rmb's value against the value of other world currencies. Many East Asian nations intervene in the foreign exchange market to preempt substantial fluctuations between the values of their currencies and the value of the Rmb.<sup>115</sup> Like the People's Bank, those nations manage their currencies by buying and selling enough U.S. dollars so that the value of their respective currency is kept artificially low relative to the value of the dollar.<sup>116</sup> To maintain the Rmb's equilibrium against its East Asian counterparts, the PBOC must also accumulate these countries' currencies along with the dollar.<sup>117</sup>

### 2. China's Mounting Foreign Exchange Reserves

The net effect of China's intervention in the currency market is that the country's foreign exchange reserve has risen dramatically in recent years. In 1999, the People's Bank had a forex reserve of approximately \$154.7 billion.<sup>118</sup> By 2005, however, that amount grew to a stunning \$840 billion.<sup>119</sup> With that increase, China is now the second largest holder of foreign currencies.<sup>120</sup>

### 3. Dispute Regarding the Peg's Economic Impact

The Chinese government contended that the purpose of the dollar-Rmb coupling was not to promote a trade advantage.<sup>121</sup> According to officials, the peg preempted significant fluctuations in the Rmb's value that would have surely destabilized China's domestic economy.<sup>122</sup> A fully convertible Rmb would lead to escalated speculative pressures in the currency markets that a fledgling Chinese banking system could not

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114. *Id.* at 2.

115. *Id.*

116. Sanford, *supra* note 18, at 3.

117. *Id.*

118. U.S. China Economic and Security Commission, *The China Currency Exchange Problem: Facts and Policy Options* (May 9, 2005), [http://www.uscc.gov/researchpapers/2005/05\\_05\\_09currency\\_exchange\\_rate.htm](http://www.uscc.gov/researchpapers/2005/05_05_09currency_exchange_rate.htm) (last visited Jan. 27, 2007) [hereinafter *The China Currency Exchange Rate Problem*].

119. Sanford, *supra* note 18, at 3. In December 2004, the PBOC's forex reserves were \$610 billion. 2004 U.S.-CHINA ECON. & SEC. REV. COMM'N ANN. REP. [hereinafter ANN. REP. 2004].

120. ANN. REP. 2004, *supra* note 119.

121. Sanford, *supra* note 18, at 1.

122. *Id.*

have sustained, because of its heavy debt burden.<sup>123</sup> They buttressed that claim by pinpointing the 1997-1998 Asian financial crisis as an omen of what happens when poorly regulated banking systems merge with convertible currencies.<sup>124</sup> Besides, eliminating the fixed exchange rate during the Asian nation's transition from predominantly state-owned enterprises would have been detrimental to China's export industries.<sup>125</sup> Furthermore, political stability would be jeopardized,<sup>126</sup> because dismantling the peg would cause the Rmb to appreciate.<sup>127</sup> Hence, the inescapable consequences of dismantling the peg would have been deflation, rising unemployment, depressed wages, and worker unrest.<sup>128</sup>

Opponents of the fixed-exchange policy view the issue otherwise. It is the U.S., they allege, that is seriously threatened.<sup>129</sup> The dollar-Rmb attachment harms America's manufacturing industry.<sup>130</sup> The textiles, apparel, and furniture sectors,<sup>131</sup> primarily, have a difficult time competing with their low-cost Chinese counterparts in the U.S. and international markets.<sup>132</sup> Consequently, in order to maintain their competitiveness, U.S. manufacturers must relocate their operations to foreign countries to take advantage of the inexpensive labor forces.<sup>133</sup> That relocation along with diminishing demands for American goods result in lost jobs in the United States.<sup>134</sup> Furthermore, those East Asian nations<sup>135</sup> with exports that are as vulnerable as U.S. exports must devalue their respective currencies against the dollar in order to keep their competitive edge.<sup>136</sup> Those devaluations cause additional burden to the U.S. manufacturing industry.

### B. *The 2005 Revaluation*

In the face of considerable external pressure, including from the

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123. Morrison & Labonte, *supra* note 9, at 2-3.

124. *Id.*; see also Jonathan E. Sanford, CRS Report for Congress, *China's Currency: U.S. Options*, at 2 (2005).

125. See Morrison & Labonte, *supra* note 9, at 2.

126. *Id.* at 3.

127. *Id.* at 2-3.

128. *Id.* at 3.

129. See *id.* at 2.

130. Sanford, *supra* note 124, at 2.

131. Morrison & Labonte, *supra* note 9, at 2.

132. *Id.* at 2.

133. *Id.* at 6.

134. See generally *PRC's Pegged Exchange*, *supra* note 17.

135. There is evidence supporting Japan, Taiwan, and South Korea's intervention in the currency market to prevent their respective currencies from declining significantly against the dollar. Morrison & Labonte, *supra* note 9, at 5.

136. See *id.* at 2.

International Monetary Fund<sup>137</sup> (“IMF”), the People’s Bank announced a revaluation of the Rmb on July 21, 2005.<sup>138</sup> Although the PBOC maintained the 0.3% trading band,<sup>139</sup> the revaluation imposed an immediate increase in the currency’s value from approximately 8.28 to 8.11 Rmb to the dollar—an appreciation of approximately 2.1%.<sup>140</sup> Additionally, the People’s Bank revealed that the value of the Rmb would be linked to a basket of currencies, instead of just the U.S. dollar.<sup>141</sup> The currencies of China’s top trading partners—the U.S., European Union, Japan, and South Korea—would dominate the basket, but the currencies of some of China’s lesser trading partners—namely, Singapore, Malaysia, Russia, Australia, and Canada—would also be included.<sup>142</sup> Finally, the PBOC confirmed that the basket composition would be affected by the strength of the trade between China and its trading partners.<sup>143</sup>

#### IV. U.S. Reaction to the Currency Relationship

U.S. Treasury Secretary John W. Snow applauded the announcement from the People’s Banks about the Rmb’s upward revaluation. Secretary Snow heralded the change as a positive step that showed that China was committed to allowing market forces to determine the value of the Rmb.<sup>144</sup> That commitment was a crucial element in resolving one of the “biggest economic disputes” between the two governments.<sup>145</sup> Despite Snow’s optimism, some critics questioned whether the revaluation was a true reform in Chinese monetary policy or a token gesture to assuage growing tensions in the U.S. Congress regarding the effect that the currency peg has upon the bilateral trade deficit.<sup>146</sup> The concerns of the critics appeared to be more in line with reality as the Rmb’s value against the dollar only appreciated by a meager 0.16% by October of 2005.<sup>147</sup>

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137. See Elizabeth Becker, *I.M.F. Asks China to Free Its Currency from Dollar*, N.Y. TIMES, Sep. 30, 2004, at C1.

138. Bradsher, *supra* note 111.

139. Peter S. Goodman, *China Ends Fixed-Rate Currency*, WASH. POST FOREIGN SERV., July 22, 2004, at A01.

140. Bradsher, *supra* note 111.

141. Goodman, *supra* note 139.

142. Reuters, *China: List of Currency in Managing Yuan*, N.Y. TIMES, Aug. 10, 2005, at C4.

143. *Id.*

144. Goodman, *supra* note 139.

145. Andrews, *supra* note 100.

146. *Id.*

147. Neil King, Jr., *U.S. to be Patient on Yuan in Talks with China*, WALL ST. J., Oct. 10, 2005, at A2.

A. *The U.S.-China Economic and Security Review Commission on China*

Congress established the U.S. China Economic and Security Review Commission (“Commission”)<sup>148</sup> upon granting PNTR status to China.<sup>149</sup> One of the Commission’s objectives is to evaluate the implications of the U.S.-China bilateral trade and economic relationship,<sup>150</sup> including China’s compliance with its WTO obligations.<sup>151</sup>

Recently, the Commission acknowledged that for the most part, China had made efforts consistent with its WTO commitments.<sup>152</sup> It, however, cited the dollar-Rmb peg as one deficiency that U.S. officials should find problematic.<sup>153</sup> One reason for concern relates to certain immediate and long-term impact that an undervalued Rmb will have on the U.S. economy—effects that may be uncorrectable in the future.<sup>154</sup> U.S. corporations move American jobs to China in order to take an advantage of the low-cost labor force;<sup>155</sup> those jobs may never be replaced, and American workers are sure to bear the negative consequences of that loss.<sup>156</sup> Another critical reason is that the overwhelming trade deficit may result in a sudden loss of confidence in the dollar and other U.S. financial assets, both domestically and abroad.<sup>157</sup> If that were to occur, U.S. interest rates would surely increase.<sup>158</sup>

In a 2005 report, the Commission discredited persistent claims by the Chinese government that the country’s global surplus was minimal.<sup>159</sup> Instead, the Commission suggested that China’s figures were untrustworthy, because the government frequently underreported its surplus with the U.S. and its other top forty-three trading partners.<sup>160</sup> Even if the Asian nation’s trade numbers were combined with those of Hong Kong, the Commission charged that the \$58 billion dollar surplus that China reported with the U.S. is still less than one-half of the \$119.3

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148. When Congress established the Commission in October 2000, its official name was the United States-China Security Review Commission. In February 2003, the Commission’s name was amended to include “Economic and.” 22 U.S.C. § 7002 (2005).

149. *Id.*

150. *Id.*

151. *Id.*

152. See ANN. REP. 2004, *supra* note 119.

153. *The China Currency Exchange Rate Problem, supra* note 118.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

billion that the U.S. Department of Commerce recorded.<sup>161</sup>

## V. Taking Control of the Bilateral Trade Deficit

Adding to the Commission's concerns, the Bureau of Economic Analysis reported that the collective U.S. trade imbalance has resulted in rapidly escalating obligations to foreign investors.<sup>162</sup> International central banks finance seventy-five percent of the aggregate U.S. trade deficit,<sup>163</sup> of which approximately 23.3% represented the 2004 trade imbalance with China.<sup>164</sup> Consequently, from 1982 to 2004, the United States' net international investment position<sup>165</sup> declined sharply.<sup>166</sup> That deterioration—attributable to the sale of assets required to finance the trade imbalance—moved the U.S. from the strongest international asset-holding position to the largest liability standing.<sup>167</sup>

### A. Actions that Have Been Proposed

Several members of Congress have individually or collectively proposed legislation to impose tariffs on all Chinese imports into the U.S.<sup>168</sup> In a May 2005 report, the Commission recommended that such levies were viable.<sup>169</sup> Although the impact of a tariff imposition would be relatively immediate, there are disadvantages to this proposal;<sup>170</sup> the chief among them is the WTO's expressed prohibition against such tariffs. Therefore, if this strategy were instituted, the U.S. would violate its obligations under its WTO agreement.

Alternatively, the U.S.—through its executive branch—may petition the IMF for relief under that organization's currency manipulation

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161. ANN. REP. 2004, *supra* note 119.

162. Robert E. Scott, *Foreign Liabilities are Rapidly Increasing, Especially to Foreign Central Banks, Economic Snapshots* (Jun. 30, 2005), <http://www.epinet.org/content.cfm?id=2056> (last visited Jan. 27, 2007).

163. *Id.*

164. *The China Currency Exchange Rate Problem, supra* note 118.

165. Net international investment position, measured as a share of the total gross domestic product, is the value of American-owned assets abroad in excess of the value of assets owned by foreign entities in the United States. Scott, *supra* note 162.

166. *Id.*

167. *Id.*

168. Most notable is the proposal by senators Charles E. Schumer and Lindsey O. Graham, which would impose a 27.5% tariff on all Chinese imports. The tariff amount would compensate for the purported discrepancy in cost resulting from the fixed exchange rate. S. 295, 109th Cong. (2005).

169. *The China Currency Exchange Rate Problem, supra* note 118.

170. The two disadvantages, the Commission identified in its report were the increased costs of Chinese products to the U.S. consumer and the possibility of Chinese retaliation. Presumably, because China can hardly afford a trade war with the U.S., it would bring action in the WTO, which the Commission asserts would force the issue before the organization. *Id.*



proscription. The problem that arises from this proposal is that the U.S. Treasury in its 2005 International Economic and Exchange Rate Policies Report<sup>171</sup> determined that the actions of the People's Bank did not meet the IMF's threshold for currency manipulation.<sup>172</sup> Therefore, this option may not be viable.

### *B. A Revised Currency Arrangement*

A more prudent approach to either of those recommendations would be for the United States to pressure China to revise the currency basket to which the value of the Rmb is attached. In June 2005, Federal Reserve Board Chairman Alan Greenspan advocated that it was time for the Rmb to be detached from the dollar.<sup>173</sup> Because of the trade surplus enjoyed by China over the U.S.,<sup>174</sup> and its rapid overall growth, it would not be unreasonable to require the former to implement a more flexible exchange rate, like other large economies. China now has the fourth largest world economy,<sup>175</sup> and such a strategy would also allow China to protect its interest by adjusting monetary and fiscal policies as needed.

In its July 2005 announcement, the People's Bank confirmed that the currencies in the new basket were from countries that had bilateral trade with China ranging from \$5 billion to \$10 billion.<sup>176</sup> According to the IMF's Direction of Trade Statistics, that would include as much as

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171. The Omnibus Trade and Competitiveness Act of 1988 requires the Treasury Secretary to conduct yearly analyses of the exchange rate policies of foreign countries to determine if countries are manipulating the rate of exchange between their currency and the U.S. dollar for purposes of preventing effective balance of payment adjustments or gaining a competitive advantage in international economic markets. 19 U.S.C. § 2411 (1996).

172. The International Monetary Fund defines currency manipulation as a large-scale and protracted intervention in one direction to gain an unfair trade advantage. Additionally, the organization's Principles for Guidance of Members' Exchange Rate Policies mandate that member nations shall refrain from manipulating exchange rates or the international monetary system to gain unfair competitive advantage over other members unless such action is intended to prevent short-term disruptions in currency values and a member nation intervening in exchange rates must consider the impact the intervention will have on other member nations. Morris Goldstein, *Currency Manipulation and Enforcing the Rules of the International Monetary System*, at 3 (2005), <http://www.iie.com/publications/papers/goldstein0905imf.pdf> (last visited Jan. 27, 2007).

173. *China: Testimony Before the S. Comm. on Fin.*, 109th Cong. (2005) (statement of Alan Greenspan, Chairman, Federal Reserve), available at <http://www.federalreserve.gov/boarddocs/testimony/2005/20050623/default.htm> (last visited Jan. 27, 2007).

174. See generally Trade in Goods, *supra* note 3.

175. Keith Bradsher, *China Reports Another Year of Strong (or Even Better) Growth*, N.Y. TIMES, Jan. 25, 2006, C5. China's economy ranks fourth behind the economies of the U.S., Japan, and Germany. *Id.*

176. Economic Letter from Mark M. Spiegel, Vice President, Federal Reserve Bank of San Francisco, at 2 (Sept. 9, 2005), <http://www.frbsf.org> (last visited Jan. 27, 2007).

twenty-two other nations with sixty-nine percent of China's total trade.<sup>177</sup> The problem with that large basket is that several of the countries that are included are those of countries that also tie their respective currency to the dollar.<sup>178</sup> Primarily for that reason, such a large currency basket must be rejected as inadequate.

Instead, America should encourage China to narrow the basket to include only the currencies of the latter's three largest trade partners, i.e., the U.S., European Union, and Japan.<sup>179</sup> Obviously, any adverse impact suffered from the dollar by the three-currency basket could be lessened. In three different hypothetical scenarios, Mark Spiegel, Vice President of the San Francisco Federal Reserve Bank, demonstrated that if the Rmb had been based on the twenty-two nation basket from 2001 to 2005 it would have appreciated between nine and eleven percent over its pre-July 2005 value.<sup>180</sup> Presumably, the appreciation could be much more significant if a narrower currency basket were implemented.

Another advantage of this recommendation is that as the value of the Rmb increases, there would be less incentive to link other East Asian currencies to the dollar. That result would minimize the risk posed to the U.S. currency by not having those less stable economies so highly invested in U.S. assets.<sup>181</sup> Consequently, once those East Asian currencies are unencumbered from the dollar, the true value of the U.S. currency would be reflected. U.S. consumers would be forced to pay more for Chinese imports because the real cost of those goods will become evident. The long-term and significant advantage then would be the potential to stem the demand for those products.<sup>182</sup> As a result, domestically manufactured products would be more able to compete against those imports. Moreover, the cost of U.S. exports in China would also become more competitive against domestically manufactured

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177. *Id.*

178. *See id.* at 2; *see also* Morrison & Labonte, *supra* note 9, at 5.

179. *China's Exchange Rate Regime: Hearings Before the H. Subcomm. on Dom. & Int'l Monetary Policy, Trade, & Tech., H. Comm. on Fin. Serv., 108th Cong., at 4 (2003)* (testimony of Morris Goldstein, Dennis Weatherstone Senior Fellow, Inst. for Int'l Econ.) [hereinafter Goldstein].

180. In his first hypothetical, Spiegel uses a fifteen-nation currency basket based on China's \$10 billion trading partners, which resulted in an eleven percent appreciation. In the second, a twenty-two nation basket is created based on trading partners that are equal to or greater than \$5 billion, which resulted in a ten percent appreciation. In the final scenario, Hong Kong is added to the second hypothetical, which resulted in a nine percent appreciation; it should be noted that the third scenario is unacceptable because, as the author noted, Hong Kong's currency is closely pegged to that of the U.S. Spiegel, *supra* note 176, at 2-3.

181. *See generally* PRC's Pegged Exchange, *supra* note 17.

182. *See generally id.*

products in the Asian nation.<sup>183</sup>

### 1. Gradual Appreciation of the Rmb's Value

Likewise, the United States should encourage the People's Bank to raise the value of the Rmb once the three-currency basket system is adopted. Economists have debated that a gradual increase can range from a modest three to five percent<sup>184</sup> to a more aggressive ten to twenty percent<sup>185</sup> on a semi-annual or annual basis. Behind the skepticism of whether, if at all, an increase in the Rmb's value should be implemented are concerns regarding the pressure that might be placed on the Chinese economy.<sup>186</sup>

In spite of that anxiety, adopting the higher range appears to be more desirable.<sup>187</sup> Such an increase amounts to China's annual inflow of direct foreign investments of approximately \$50 billion, or four percent of its gross domestic product.<sup>188</sup> There is agreement that if a greater appreciation of the Rmb were to occur, the results would not be detrimental because the Chinese economy would not suffer significantly from running a current account deficit.<sup>189</sup> Further, because the Rmb would still be pegged to major world currencies and not fully convertible, it would have some protection. Additional safeguards that might be afforded are that the increases would be periodic; hence, the upward revaluations would be easier for the PBOC to manage against any perceived market threats.

The proposal of the People's Bank to allow the Rmb to fluctuate only within 0.3% of the new currency basket<sup>190</sup> should be held unsatisfactory. As the governor of the People's Bank stated, the July revaluation should not be regarded as an indication that there would be similar appreciations in the future.<sup>191</sup> For a decade, however, China has benefited from a stable Rmb—mostly at the expense of the U.S. dollar—while other world currencies have withstood the worst of the global currency market.<sup>192</sup> The U.S. should not permit that practice by the

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183. *Id.*

184. David R. Francis, Commentary, *Why China Needs More Expensive Money*, THE CHRISTIAN SCI. MONITOR, May 12, 2005, at 17.

185. Laura D'Andrea Tyson, Viewpoint, *A Stronger RMB Helps China. Beijing Should Use its Reserves to Update its Infrastructure and Fund Education*, BUS. WEEK, Oct. 31, 2005, at 114.

186. *See Morrison & Labonte, supra* note 9, at 2-3.

187. *See generally* Goldstein, *supra* note 179.

188. *See* Tyson, *supra* note 185.

189. *Id.*

190. Spiegel, *supra* note 176, at 1.

191. *Id.* at 2.

192. *See generally* PRC's Pegged Exchange, *supra* note 17.

PBOC to persist—particularly in light of the robust growth of the Chinese economy—and should urge the Asian nation to implement a broader fluctuation range.

In addition, there is room for leniency in this approach because it provides a more desirable opportunity to maintain the Rmb's stability. Instead of the meager 0.3% proposal, the People's Bank should employ a five to seven percent fluctuation range around the currency basket central parity as recommended by some economists.<sup>193</sup> Another viable option would be for the People's Bank to establish an undisclosed target range (with a low end set at least four percent).<sup>194</sup> Such a strategy would protect the Rmb from currency speculators whose hedging could result in destabilization.<sup>195</sup> Nondisclosure of the target range is not an unusual practice because it is widely used by other Asian nations, like Singapore, to protect their currencies against similar perceived threats.<sup>196</sup>

## 2. Proceeding with Caution

The U.S. must approach this policy with much diplomacy. As of December 31, 2004, China's foreign exchange reserve was second largest in the world only behind Japan,<sup>197</sup> while the United States is the world's largest debtor.<sup>198</sup> Therefore, that should be cause for concern to the U.S.

In February 2005, the dollar fell sharply after the South Korean central bank announced that it would start purchasing less U.S. dollars in favor of the euro and other investments.<sup>199</sup> That revelation led to speculation that if the South Korea announcement could cause that impact, a similar move by China may be more catastrophic.<sup>200</sup> Such an event could be the United States' worst economic nightmare. Should China stop investing in U.S. debt instruments and start to diversify into other foreign currency reserves, the consequence to the U.S. economy would be massive because of America's elevated national debt.<sup>201</sup>

The reaction to the South Korean announcement portends the

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193. Goldstein, *supra* note 179.

194. Barry Eichengreen, *China Should Unpeg the Renminbi (sic) Now*, at 5 (2003), <http://www.econ.berkeley.edu/~eichengr/reviews/swissreview13aug5-03.pdf> (last visited Jan. 27, 2007).

195. *Id.*

196. *Id.*

197. *See generally* PRC's Pegged Exchange, *supra* note 17.

198. Scott, *supra* note 162.

199. Cnn.com, *Dollar Tumbles, Bond Slides. South Korea Central Bank May Fill Reserves with Other Currencies, Others Thought to Follow Suit*, (Feb. 22, 2005), <http://money.cnn.com/2005/02/22/markets/bondcenter/bonds/> (last visited Jan. 27, 2007).

200. *See generally id.*

201. *See generally* Scott, *supra* note 162.

economic vulnerability of the U.S. The longer the American government allows the People's Bank to accrue the dollar in an effort to protect the Rmb, the more detrimental the consequences could be for the American economy. The U.S. should act accordingly to curtail this practice.

*C. Standing Under the WTO Agreements*

Based upon this premise, the U.S. has a viable cause against China for the latter's violation of its WTO obligations. As WTO members, the U.S. may seek recourse against China under the organization's dispute resolution system. Because the PBOC's currency arrangement decreases the cost of Chinese imports into the U.S. and increases the cost of U.S. exports, it is debatable whether the peg acts like a subsidy to Chinese importers. Based upon that assertion, the U.S. has an argument that China is in violation of its WTO obligation.

Furthermore, the WTO Agreement has guidelines for how its member nations should treat their currencies in order to afford some measure of fairness in the international exchange market. Section IV of Article XV of the Agreement forbids contracting parties from frustrating, via currency intervention, "the intent of the provisions of [the] Agreement, [or] by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund."<sup>202</sup>

*D. U.S. v. China in the World Trade Organization*

Since its entry into the WTO, the U.S. and China have faced off only once before the organization's dispute resolution panel. In March 2004, the U.S. Trade Representative initiated a case against China regarding the Asian nation's seventeen percent value-added tax ("VAT") levied against U.S. exports of integrated circuits.<sup>203</sup> The U.S. argued that the Chinese government taxed compatible semiconductors that were manufactured domestically in the Asian nation at a relatively minimal rate of three percent.<sup>204</sup> After several rounds of negotiations before the WTO panel, which lasted about four months, the two nations entered into an agreement whereby China would immediately cease to offer this advantage to new designers of semiconductors that were domestically based.<sup>205</sup> Additionally, by April 1, 2005, the practice would terminate

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202. World Trade Organization, WTO Agreement, art. XV, § 4.

203. Press Release, The Office of the U.S. Trade Representative, U.S. and China Resolve WTO Dispute Regarding China's Tax on Semiconductors (July 8, 2004), available at [http://www.ustr.gov/Document\\_Library/Press\\_Release/2004/July/US\\_China\\_Resolve\\_...](http://www.ustr.gov/Document_Library/Press_Release/2004/July/US_China_Resolve_...) (last visited Jan. 27, 2007).

204. *Id.*

205. *Id.*

completely.<sup>206</sup>

As a result of this case, the U.S. government should feel confident that it can prevail in a legitimate case brought against China. As previously stated, the currency arrangement functions much like a subsidy; therefore, it parallels the trade disadvantages of the VAT in the semiconductor dispute.

## VI. Conclusion

The U.S. has seen its trade deficit with China explode over the past twenty years. During that period, the Asian nation has become the United States' largest trading partner. Although China contends that it competes fairly against the United States in international and reciprocal trade, the evidence demonstrates otherwise. In fact, it reveals that the long-standing dollar-Rmb peg that the People's Bank of China has maintained spurs China's trade surplus with the United States. This problem is further exacerbated now that China is a member of the WTO and has complete and free access to the U.S. markets.

In order to combat this increasing disadvantage, the U.S. must compel the Chinese government to live up to the obligations it assumed upon its recent accession to the WTO. To accomplish this outcome, the U.S. must demand that the People's Bank of China revalue the Rmb and adopt a more equitable managed currency system. That should serve to protect the U.S. and Chinese domestic economies.

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206. *Id.*

