Indiana Journal of Global Legal Studies

Volume 25 | Issue 1 Article 19

2-15-2018

The Globalization of United States Debt: The Real Impact of China's Rise as a Creditor State

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ABSTRACT

In this Note, I seek to answer a simple question: By owning a large quantity of United States debt, can a foreign country influence United States policies at home or abroad? To answer, I apply scholarship in financial leverage theory to China—the largest foreign holder of U.S. debt. As a result, I find no plausible threat of China using financial leverage against the United States.

Instead, I argue that the true impact of China's rise as a creditor state has been its ability to fundamentally undervalue its currency by investing in the sovereign debt of foreign nations. Such monetary policies run contrary to China's obligations with the International Monetary Fund and expose the need for a more effective international enforcement mechanism for intentional currency devaluations. While the World Trade Organization's Dispute Settlement Board may provide an alternative solution, I believe China's emergence as a trading power will insulate it from international punishment.

In the end, I look to the market, or "global invisible hand" for solace. I argue that over the long term the global market will act as a regulator and will rein in China's currency policies as the country liberalizes its markets and begins to shift away from a traditional export-driven economy.

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Indiana Journal of Global Legal Studies Vol. 25 #1 (Spring 2018)

INTRODUCTION

Over the past decade, China has emerged as a creditor nation, building up foreign currency reserves and investing in the sovereign debt of foreign nations. At the moment, China owns over a trillion dollars of United States debt, leaving many Americans afraid that the Chinese have the power to influence the United States' stance on domestic and foreign issues.

However, I argue the real impact of China's emergence as a creditor nation is that the country's reclamation of its monetary sovereignty has allowed it to manipulate global currency markets to fundamentally undervalue Chinese currency. While these manipulative policies are contrary to China's obligations with the International Monetary Fund (IMF), the lack of an effective international enforcement mechanism has allowed the country to grow its economy into one of the most powerful trading nations in the world. As a result, even if an effective enforcement solution is found, it is too late to have a significant impact on China's monetary policy. Rather, I argue the global market—or the "Global Invisible Hand"—will act as a regulator as China's economic focus begins to shift away from its traditional export-driven economy.

In this Note, I proceed by first explaining why China is central to any study concerning the globalization of U.S. debt. Second, I debunk the "Great Myth," or the idea that China can use its position as a creditor nation to influence U.S. policy. Third, I analyze what I believe to be the real impact of China's rise to creditor status: its ability to fundamentally undervalue its currency. Fourth, I provide a brief historical background of how the IMF was created to stop currency devaluations, but also highlight current flaws in the IMF regulatory system. Fifth, I briefly summarize the World Trade Organization's (WTO) dispute resolution process as an alternative enforcement approach. Lastly, I explain why the "Global Invisible Hand" will correct China's currency policy as the country shifts its economic focus.

I. WHY FOCUS ON CHINA?

It is important to analyze China's rise as a creditor nation, because as an authoritarian regime its emergence as a global leader poses interesting challenges for the United States. The two countries disagree on a myriad of global issues including nonproliferation, security in the Pacific Rim, humanitarian intervention, and global governance structures.[1] As China wields more global influence, it is important to know whether the country can influence U.S. policy on global issues.

Moreover, China is central to any study concerning the foreign-held U.S. debt, because China owns more U.S. debt than any other foreign nation. Currently, the country owns 1.185 trillion dollars of U.S. dollar-denominated debt, about one-third of the total of all other nations combined.[2] Since 2005, China has built up an unprecedented amount of foreign currency reserves in order to keep the value of its currency, the Yuan Renminbi (RMB), artificially low relative to major currencies.[3] By intentionally keeping the value of the RMB low, China makes its goods relatively less expensive than goods produced in other export-driven economies, enticing U.S. companies and consumers to buy goods from the Chinese marketplace.[4] Unquestionably, the undervaluation of the RMB is directly attributable to international competition.[5]

But before one can analyze risks associated with China's ownership of such a large quantity of U.S. debt, it is important to understand the mechanics of how the country uses foreign reserves to implement its currency policies. In the most simplified terms, to devalue the RMB, the People's Bank of China buys U.S. dollars (USD) in the open market, while simultaneously printing its own currency.[6] As a result, China accumulates huge foreign reserves of U.S. cash,[7] which it must safely invest while at least earning the risk-free rate.[8] To do this, the People's Bank of China invests in U.S. Treasury bills, notes, and bonds, considered by most investors to be the safest investments on earth because the U.S. government backs them.[9] U.S Treasury securities are

1. Daniel W. Drezner, *Bad Debts: Assessing China's Financial Influence in Great Power Politics*, 34 INT'L SECURITY 7, 21 (2009).

2. U.S. DEP'T OF THE TREASURY, MAJOR FOREIGN HOLDERS OF TREASURY SECURITIES, (Nov. 15, 2017), http://ticdata.treasury.gov/Publish/mfhhis01.txt. At the time of this article, the most recent figures are from August 2016 where the total amount of U.S. debt held by foreign countries was 3.949 trillion dollars.

3. Alexandra Esmel, *Currency Wars: The Need for International Solutions*, 43 DENV. J. INT'L L. & POL'Y 403, 407 (2015).

4. *Id.* at 408.

5. *Id.* ("The link between [China's] monetary policy to artificially keep the RMB undervalued allow[s] them to lower [a firm's] cost of production in key industries relative [] to [] world prices and [to] flood foreign markets [with] their exports.").

6. *See* Anthony Yu, Comment, *China's Currency Practices and "Currency Manipulation": The Power of Action in Inaction*, 26 GLOBAL BUS. & DEV. L.J. 577, 581 (2013) (examining how Chinese intervene in foreign exchange markets by releasing and buying foreign reserves, while the Euro, Japanese Yen, and British Pound "float" with market forces to determine their value).

7. Foreign reserves of U.S. dollars are essentially piles of U.S. cash.

8. The risk-free rate is the rate of return that allows an investment to keep pace with inflation.

9. *See* THOMAS OATLEY, INTERNATIONAL POLITICAL ECONOMY 336 (5th ed. 2013).

debt securities. Thus, China is effectively lending money to the U.S. government in exchange for a return on its investment. Put simply, China buying 1.13 trillion dollars of U.S. Treasury securities is the equivalent of extending the U.S. government a 1.13 trillion dollar loan.

II. THE GREAT MYTH OF FOREIGN-HELD DEBT

As an authoritarian regime, China's possession of so much U.S. debt inevitably begs the question: Can China affect domestic policy here in the United States? This is what I call the "Great Myth" of foreign-held debt—that China has the ability to use its financial leverage to influence U.S. politics. Politicians often use coercion rhetoric to boost agendas for budget cuts and "belt-tightening."[10] This rhetoric often comes from the political right, but even President Obama in 2007 warned of the dangers of China financing large portions of America's debt, stating, "It's pretty hard to have a tough negotiation with the Chinese when they are our bankers."[11]

Yet, China's rise as a creditor nation does not give it leverage to influence U.S. policy.[12] It is true that China lends money to the United States through the open market and that the United States and China have entered into a debtor-creditor relationship. Most Americans compare this relationship to the typical debtor-creditor relationship where a debtor's need for cash leaves the debtor vulnerable to the creditor's demands. But it is important to remind ourselves that we are not talking about banks and individuals. We are talking about the two most powerful countries in the history of the world, influenced by markets and law.

The United States and People's Republic of China are home to the two largest economies in the world by Gross Domestic Product (GDP).[13] After China passed Japan as the largest foreign holder of U.S. debt in 2008,[14] intense discussion emerged among scholars and economists concerning China's ability to influence U.S. politics. These discussions centered on what was termed "Financial Leverage Theory:" the ability of a creditor state to use its economic position to influence the policies of a

10. MARK BLYTH, AUSTERITY: THE HISTORY OF A DANGEROUS IDEA 5, 8 (2013) (arguing that in the wake of the recent economic recession, politicians continue to sound the horn of a "sovereign debt crisis" to reduce the United States debt; but according to Blyth, the crisis was not about debt, it was about flaws in the banking system.).

11. Drezner, *supra* note 1, at 15.

12. *Id.* at 18.

13. *GDP Ranking*, THE WORLD BANK, http://data.worldbank.org/data-catalog/GDP-ranking-table (last updated July 1, 2017) (click one of the file types in the right column to download rankings).

14. Drezner, *supra* note 1, at 8.

debtor state.[15] Scholarship in this area widely indicates that China is not in a position to use its status as a creditor nation to influence U.S. policy.[16]

Four factors must exist for financial leverage to cause a target state to concede ground on domestic and global issues.[17] The target state must "be unable to find alternative sources of credit; lack the capability to inflict costs on the coercing state in retaliation to any financial pressures; anticipate few conflicts with the coercing state over time; and try to maintain a fixed exchange rate regime."[18] None of these factors hold true in China–U.S. relations.[19] Further analysis reveals how the global market and the interdependency of the two countries prevent each nation from using financial statecraft to influence each other's policy agendas.

First, the United States—more than any other country—has the ability to obtain financing from sovereign nations and private sector investors. Ever since the Bretton Woods Conference in 1944, the U.S. dollar has been the world's main reserve currency.[20] As a result, it is often in the best interest of countries and multinational corporations to buy U.S. dollar denominated assets in order to facilitate international trade.[21] Also, the dollar is also considered a "safe-haven" in times of global economic turmoil.[22] During periods of uncertainty, central banks and private investors around the world park their money in U.S. Treasury securities. Thus, the United States can quickly accumulate needed funds in an economic downturn, while paying relatively low interest on its debt.[23]

Second, as the largest economy in the world, the United States is well positioned to inflict significant costs on the Chinese economy in retaliation to any coercive tactics implemented by the Chinese. China's best bargaining chip would be a massive sell-off of its U.S. holdings and treasury investments, a move that would collapse the value of the U.S. dollar overnight.[24] However, if China were to dump its U.S. holdings or scale back its purchase of U.S. assets, the RMB would appreciate in value relative to the dollar. This strategy would place significant costs on China's own economy, as it is estimated that a ten percent

15. *Id.* at 10.
16. *Id.* at 20.
17. *Id.*
18. *Id.*
19. *See id.*
20. Blyth, *supra* note 10, at 1.
21. *Id.* at 18.
22. Drezner, *supra* note 1, at 20.
23. *See id.* at 41.
24. *Id.* at 21 (calling this China's "nuclear option").

appreciation of the RMB translates to a loss equivalent of three percent of China's GDP in its foreign reserves.[25] Not to mention, Chinese exports and manufacturing industries would take a hit as its goods would become more expensive overnight. Moreover, any type of economic statecraft would likely initiate a trade war with the United States, which China will not risk. The country has had a trade surplus with the United States in excess of 200 billion dollars a year for over a decade,[26] a relationship it surely wants to continue.

Third, China's rise as a global power has exposed a breadth of policy disagreements between China and the United States. These high expectations of future conflicts greatly reduce the chance that the United States will concede to any financial pressure exerted by China for fear of weakening its bargaining power in the future.[27]

Lastly, China will not be able to use financial leverage against the United States because the United States does not employ a fixed exchange rate regime. Rather, the U.S. issues debt denominated in its own currency which constrains China from exerting influence as a creditor state because China's U.S. debt securities promise future payments in U.S. dollars.[28] Therefore, Chinese threats to sell off its U.S. holdings are inherently less credible because any financial attack that weakens the value of the U.S. dollar also erodes the future value on 1.13 trillion dollars of China's U.S. holdings.[29] If anything, the current monetary regime limits Chinese action in respect to its foreign reserves, as the country cannot maintain its trade surplus if it allows the RMB to appreciate relative to the dollar.[30]

Drezner argues that "[t]he importance of the American market to Chinese exporters—and the threat of trade retaliation in the face of Chinese financial statecraft—highlights the mutual dependency of the two economies."[31] This mutual dependency indicates that the global market can act as a regulator. Even though the two countries are rooted in different political systems, it is in their mutual interests to maintain the status quo as both benefit from the flow of goods and capital

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25. Gregory Chin & Eric Helleiner, *Calling China's Bluff: Why It's Far Too Early to Fear China's Burgeoning Financial Clout*, FOREIGN POLICY (Jan. 23, 2009, 12:00 AM), http://foreignpolicy.com/2009/01/23/calling-chinas-bluff/.

26. UNITED STATES CENSUS BUREAU, TRADE IN GOODS WITH CHINA (2017), https://www.census.gov/foreign-trade/balance/c5700.html.

27. Drezner, *supra* note 1, at 20–21.

28. *Id.* at 21.

29. *Id.*

30. *Id.* at 22.

31. *Id.* at 21 (highlighting how this interdependence between the two economies makes it difficult for China to credibly threaten financial leverage against the United States).

between the two countries. As an effect, the global market limits each of these countries' ability to force policy changes on the other.

III. THE REAL IMPACT OF CHINA'S RISE AS A CREDITOR NATION

While China cannot control U.S. policy, the real risk of China holding so much U.S. debt is that China's domestic policies have become insulated from international scrutiny—just as U.S. policies are insulated from the Chinese. In a study of the United States' use of capital markets to force policy changes in China, Russia, and Sudan, Benn Stiel and Robert Litan found the U.S. efforts to be fruitless as the other countries were able to find alternative sources of credit at minimal costs.[32]

Yet, I believe the real risk of China holding so much U.S. debt is that its rise as a creditor nation helped it regain its monetary sovereignty and increase its influence over global markets. Enabled by a lack of international regulation and enforcement, China has used its currency policies of undervaluing the RMB—policies which violate agreements with the IMF—to grow into the second largest economy in the world.[33] These currency policies were predicated upon an increase in foreign reserves, which ultimately led to the emergence of China as a creditor state.

China's ability to violate IMF agreements (discussed below) is a humble reminder that sometimes in the short-term, "[m]arkets are neither self-governing nor [are] necessarily democratic."[34] Often, the biggest problem with regulating on a global scale is enforcement. However, even if effective international enforcement measures are implemented, it may be too late to enforce Chinese currency violations as the lack of IMF enforcement has allowed the country to grow into one of the world's most powerful trading nations. As a result, most countries will avoid confronting China on currency issues for fear of trade repercussions.

But is there some sort of "global invisible hand" where, given enough time, the global market will eventually act as a regulator to stop or prevent countries like China from intervening in the global currency markets? Analysis of this question necessitates an understanding that markets and law are institutions, and, as such, they are made up of

32. BENN STEIL & ROBERT E. LITAN, FINANCIAL STATECRAFT: THE ROLE OF FINANCIAL MARKETS IN AMERICAN FOREIGN POLICY 73 (2006).

33. *See* Yu, *supra* note 6, at 581–82.

34. ALFRED C. AMAN, JR., THE DEMOCRACY DEFICIT: TAMING GLOBALIZATION THROUGH LAW REFORM 3 (2004).

social dynamic processes.[35] Consequently, markets and legal institutions are constantly being shaped by thousands of issues pulling in different directions. I believe that in the long-term, China will rein in its currency policies to achieve other economic objectives. The global market will act as a long-term regulator, but a more effective enforcement system will still be needed at the international level.

A. History: IMF Created to Stop Currency Devaluations

In the years leading to the Great Depression, countries engaged in the intentional undervaluation of their currencies to gain competitive trade advantages relative to their neighbors.[36] Looking out for their own economies, each country competitively undervalued its currency to try and have the cheapest exports.[37] A race to the bottom ensued, and in combination with other protectionist trade policies, the global economy spiraled into a state of depression.[38]

Looking at the big picture, it is easy to see that the problem boiled down to a divergence between domestic and international interests. Each country had a stake in looking out for its own economy, but when countries enacted competitive currency devaluations at the same time, the world's economies crashed. Thus, after the Great Depression and World War II, the international monetary system "moved from an informally regulated laissez-faire model to a genuinely international system whereby nations surrendered a degree of economic sovereignty and accepted a measure of oversight by international institutions."[39]

Implicit in this move away from a traditionally laissez-faire model are two possibilities. First, perhaps the world powers realized that in certain circumstances, such as the interwar period between the First and Second World Wars, no "global invisible hand" would correct the international market from the competitive currency devaluation and other protectionist trade policies. However, another possibility exists. Maybe a market correction did take place; it was just in the form of a global depression. In this case, the move away from the laissez-faire system indicates that the world governments were unwilling to accept

35. *Id.* at 10 ("Markets and law are institutions and, as for all institutions, this means they are dynamic social processes, not monolithic entities.").

36. Jeffrey S. Beckington & Matthew R. Amon, *Competitive Currency Depreciation: The Need for a More Effective International Legal Regime*, 10 J. INT'L BUS. & L., 209, 213 (2011) (claiming competitive currency devaluation was an attempt for governments to "fill a legal vacuum in the absence of international consensus and coordination").

37. *Id.*

38. *See id.* at 209.

39. *Id.* at 211.

that market's solution because real people fell into human suffering as they lost their jobs during the Great Depression.

Either way, the IMF was created at the UN Conference at Bretton Woods in July 1944 "to build a framework for international economic cooperation in order to avoid repeating the competitive devaluations that contributed to the Great Depression of the 1930s."[40] According to the IMF, "the IMF's primary mission is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries and their citizens to transact with each other."[41]

The establishment of the IMF was an unprecedented ceding of monetary authority,[42] but one almost natural for Americans who predicate state authority on a vertical hierarchy of power.[43] Each member state ceded a level of its sovereignty by giving up its untainted right to interfere in its own currency markets. Until that point, a country's currency policy was considered to be a wholly domestic right, completely insulated from international regulation.[44] But not far removed from the Great Depression, countries were willing to cede some sovereign authority in exchange for international stability.[45]

The promise of the IMF was the possibility of a stable international monetary system.[46] From 1946 to 1971, the IMF regulated a fixed parity exchange rate system, in which the value of each nation's currency was defined in terms of the U.S. dollar, and the U.S. dollar was defined by gold reserves.[47] Countries could manipulate their currencies up to ten percent away from the levels set by the IMF, and any manipulation past ten percent required approval by the IMF Member States.[48]

B. Interlegalities Between Domestic and International Law

Ironically, this fixed parity system fell apart in 1971, when the United States devalued the dollar twice without the IMF's consent,

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40. *About the IMF*, INT'L MONETARY FUND, http://www.imf.org/en/About (last visited Oct. 13, 2017) (click "IMF at a Glance").

41. *Id.*

42. Beckington & Amon, *supra* note 36, at 209.

43. AMAN, JR., *supra* note 34, at 3 ("[T]he federal government *over or above* the states; the states *over or above* local communities; and, looking outward from the United States, transnational organizations *over* national organizations.").

44. Beckington & Amon, *supra* note 36, at 213.

45. *See id.* at 241.

46. *Id.*

47. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 1 (2011).

48. *Id.*

sending the currency markets into turmoil.[49] The current IMF system was adopted in 1978, which resulted in the IMF implementing a regulatory structure in between a traditional laissez-faire structure and a fixed-rate system pegged to the U.S. dollar.[50] Countries were allowed to use a fixed or floating exchange rate system, so long as they agreed to follow the IMF guidelines and did not use gold as the basis for their currency's value.[51]

However, I believe the amendment in 1978 exacerbated the tension between a country's interest in controlling its own currency valuations and the international interest of stability. The IMF amendment created what Mariana Valverde refers to as "interlegalities."[52] Interlegalities exist at the intersection of different legal systems designed to regulate different regulatory scales.[53] For currency manipulation, interlegalities occur at the intersection of national and international interests, since a country's domestic fiscal policies may diverge from the rules governed by the IMF.

At the domestic level, monetary sovereignty, or the ability to adapt to currency valuations, is critical for any country's economy.[54] This notion is especially true for developing countries with export-driven economies.[55] By exercising monetary sovereignty to undervalue a currency, a state can protect its domestic industries from foreign competition, attract foreign direct investment, and influence the market price for exporting goods and services.[56] Unquestionably, these short-term benefits led China to pursue its currency devaluations policies in the interest of its own economy.

In 2010, economists William Cline and John Williamson, with the Peterson Institute for International Economics, estimated that the Chinese RMB was undervalued relative to the U.S. dollar by about twenty percent.[57] Effectively, this made Chinese exports twenty percent cheaper than American exports, which helped to expand China's economy and the number of available jobs in the short-term. This study suggests that China had a substantial trade advantage over other

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49. *Id.*

50. *Id.*

51. *Id.*

52. Mariana Valverde, *Jurisdiction and Scale: Legal 'Technicalities' as Resources for Theory*, 18 SOC. & LEGAL STUD. 139, 141 (2009).

53. *Id.*

54. *See* Esmel, *supra* note 3, at 404–05.

55. *Id.*

56. *Id.*

57. *See* Beckington & Amon, *supra* note 36, at 255 (citing a study by William R. Cline and John Williamson of the Peterson Institute for International Economics which compares levels of effective exchange rates with fundamental equilibrium exchange rates).

exporting nations, and thus, inherently undermined its core agreement with the IMF to not intentionally devalue its currency to sustain unfair trade advantages.

IV. THE PROBLEM WITH THE IMF: A LACK OF ENFORCEMENT

To understand why the IMF lacks the ability to efficiently enforce China's currency manipulations, one must first look to the language in the IMF's General Obligations of its member states. Article IV(1)(iii) of the IMF Articles of Agreement states, "member countries *shall* avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment *or to gain an unfair competitive advantage* over other members."[58]

The first problem is that the language of the member obligations makes it virtually impossible to prove a violation under the IMF Articles of Agreement.[59] To establish that China has violated Article IV of the IMF Articles of Agreement, two elements must be shown. First, a complaining country must show that the People's Bank of China has taken deliberative action to manipulate its exchange rate, which China has a right to do to a certain extent.[60] In reality, this is easy to prove because manipulation can occur by a central bank buying or selling foreign currencies to influence the value of their own currency.[61] Under this prong, policies such as quantitative easing are sufficient to prove the first element, and consequently the majority of large countries around the world are considered to be "currency manipulators."[62] Although a negative political connotation surrounds "currency manipulation," manipulation alone is not enough to warrant a violation under the IMF.

Second, the language of Article IV provides that a violation occurs if the manipulator engaged in the currency manipulation with the *intent* to gain an unfair competitive advantage over another country.[63] This provision tries to limit interlegalities between national and

58. Articles of Agreement of the International Monetary Fund, art. IV(1)(iii), July 22, 1944, 60 Stat. 1401, 2 U.N.T.S. 39 (amended by Second Amendment of Articles of Agreement of the International Monetary Fund, 29 U.S.T. 2003 (1967-1977)) [Hereinafter "IMF"] (emphasis added).

59. *See* Esmel, *supra* note 3, at 420; SANFORD, *supra* note 47, at 2.

60. *See* SANFORD, *supra* note 47, at 1–2 (until 1971, countries had the right to manipulate currency values within 10 percent of IMF rate, and current rules allow for currency manipulation as long as the manipulation was not done to gain an unfair advantage).

61. *See* Esmel, *supra* note 3, at 420.

62. *See id.*

63. *Id.* at 420–21.

international scales by creating a framework where countries cannot promote their own economies to the detriment of international stability. As evidenced by history, countries taking manipulative measures to advantage their own economies could lead to competitive devaluations that shrink the global economy—the exact problem the IMF was founded to prevent.

Nevertheless, countries suspected of manipulating currency markets with the intent of gaining unfair trade advantages easily evade violations under Article IV by justifying the manipulation on valid domestic policy grounds.[64] In preparing a report for Congress, Jonathan E. Sanford, a specialist in international trade and finance, cited how countries commonly justify currency manipulations with the valid objective of "stabiliz[ing] the value of their currency in order to prevent disruption to their domestic economic system."[65] Regardless, some evidence indicates that the IMF avoids confrontation when powerful countries are involved in potential currency manipulation.[66]

Yet even if a country could establish that China has violated Article IV, the IMF does not possess an effective enforcement process to correct the violation.[67] Under Article IV, the IMF is required to engage in surveillance over exchange rate policies, but it cannot force a country to change its exchange rate.[68] The breadth of the IMF's enforcement capabilities is to offer advice to potential violators and to provide a forum for countries to urge currency manipulators to change their exchange rate procedures.[69] However, the ultimate authority to change an exchange rate resides with the country suspected of violating Article IV.[70]

China's rise as a creditor nation, and its emergence as the world's second largest economy, has given the country the power to keep international organizations and democratic nations from influencing its domestic monetary policies. For example, in 2008, the year that China became the largest foreign holder of U.S. debt, China successfully vetoed the IMF's attempt to investigate whether the RMB was fundamentally misaligned.[71] Moreover, I believe the more trading power China possesses, the less willing Member States will be to bring challenges against China's currency policies. The inability of the IMF to

64. *See* Esmel, *supra* note 3, at 420; *see also* SANFORD, *supra* note 47, at 2.

65. SANFORD, *supra* note 47, at 2.

66. *See* Robert W. Staiger & Alan O. Sykes, *'Currency Manipulation' and World Trade*, 9 WORLD TRADE REV. 583, 584–85 (2010).

67. *See* SANFORD, *supra* note 47, at 2.

68. *Id.*

69. *See id.*

70. *Id.*

71. *See* Beckington & Amon, *supra* note 36, at 254.

effectively deal with China's policies has led many scholars to look to other areas of international law to stop currency manipulation through effective enforcement mechanisms.

V. THE WTO AS A SOLUTION TO INTERNATIONAL ENFORCEMENT

Many argue that the World Trade Organization (WTO) should handle violations under the IMF. In international law, the WTO is somewhat of a unique international body because it possesses a mechanism for enforcing its rules through its Dispute Settlement Board.[72] Through this enforcement mechanism, a country may request that a dispute settlement panel hear its complaint if it believes another country violated WTO rules to its detriment.[73] Under this system, the accused country cannot veto the appointment of the panel or the adoption of a WTO decision, like it can under the IMF.[74]

If a violation is proven, and the losing party refuses to comply with the WTO ruling within a reasonable amount of time, the WTO will authorize the complaining country to implement retaliatory measures against the offending country.[75] This dispute resolution system has attracted large support as a means to handle currency violations, but whether currency disputes should fall under the WTO's jurisdiction is a debated topic.

A. Jurisdictional Hurdles Concerning the WTO

Many economists agree that currency devaluations should be covered as an export subsidy under the General Agreement against Tariffs and Trade (GATT), a predecessor agreement to the WTO.[76] This is a very plausible argument as an undervalued currency has the same practical effect as an export subsidy for a country's domestic export producers. Yet, the main jurisdictional hurdle is that currency devaluations do not fit the WTO's strict definition of what constitutes an export subsidy.[77]

Others argue that the amendment to the 1996 version of Article XV:2 of the GATT provides sufficient jurisdictional ties for the WTO to

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72. *See* SANFORD, *supra* note 47, at 2; *see also* Esmel, *supra* note 3, at 423 ("The WTO is known for having the most effective enforcement system in international law.").

73. *See* SANFORD, *supra* note 47, at 2.

74. *Id.*

75. *Id.* at 2–3.

76. *See id.* at 3; *see also* Esmel, *supra* note 3, at 426–27.

77. SANFORD, *supra* note 47, at 3.

enforce currency violations under the IMF.[78] In 1996, the two international organizations agreed to "consult with each other in the discharge of their respective mandates" to achieve greater coherency in global economic policies.[79] This provision allows the WTO to work in conjunction with the IMF, and to default to the IMF's expertise on issues involving the international monetary system.[80] However, while the WTO and IMF agreed to communicate with each other on matters of "mutual interest," the WTO dispute settlement panels are specifically excluded from the agreement.[81] Although this cooperation between the IMF and WTO is encouraging, it has not been sufficient to overcome the jurisdictional hurdle for currency violations to be brought under the WTO.[82]

The final argument is to change the actual language of the IMF and WTO articles to grant the WTO jurisdiction over currency violations.[83] However, to change the IMF articles, eighty-five percent of the IMF Member States have to approve the change for the amendment to be effective.[84] It is unlikely that any nation that moves for an amendment will be successful because the majority of the member countries seem to be content with the present system.[85] Additionally, countries likely do not want to give up more monetary sovereignty amid fears of giving the IMF too much power over their domestic economies.[86] Changing the WTO agreements is even less realistic, as the organization requires unanimous consent of all its members for a change to be ratified.[87]

VI. THE GLOBAL INVISIBLE HAND

Effective enforcement efforts through the WTO need to be implemented to stop countries from devaluing their currencies and destabilizing international markets. However, in the case of China, even if jurisdiction could be granted for the WTO to handle currency disputes, there would be little to no impact on Chinese currency policies because of the country's standing as an international trading power.

Hypothetically, if the United States brought a complaint against China under the WTO Dispute Settlement Board for a violation of IMF

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78. *Id.* at 4.
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.* at 5.
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.* at 6.

Article IV, winning would only authorize the United States to take retaliatory measures against China in the form of trade tariffs and quotas. In response, China would retaliate and implement an economic sanction of its own, regardless of whether the WTO authorized it. Such actions would inevitably start a trade war.

Illustrating this point, in 2011, the U.S. Senate passed the Currency Exchange Rate Oversight Reform Act to impose countervailing duties on Chinese goods if it found China had been undervaluing its currency.[88] The Act failed to gain support in the House of Representatives, and the Chinese foreign ministry spokesman, Ma Zhaoxu, used the opportunity to indicate that there would be repercussions that would "severely upset China-U.S. economic and trade relations."[89] As mentioned above, the interdependencies of the two economies make U.S. intervention in Chinese currency policies unlikely for fear of economic retaliation.[90]

In a sense, the IMF has missed its best chance to regulate China's currency policies. As China became a creditor nation, investing its foreign reserves in the sovereign debt of other nations, its economy gained a distinct advantage over other exporting nations that were complying with the IMF rules. China utilized the benefits of an artificially low currency to grow into the second largest economy in the world. Even if countries could establish a violation under the IMF, and assuming they could find an effective means of enforcing the violation, many would elect not to for fear of alienating one of the largest trading partners in the world.

Instead of confronting China through the IMF forum, other exporting nations that are truly disadvantaged by China's currency policies will likely revert to devaluing their own currencies to keep their export-driven economies competitive. Therefore, China's rise as a creditor nation inherently brings instability to the global monetary system as long as the country continues to neglect its obligations under the IMF.[91]

Yet, I believe there is still hope that the global market can act as a regulator in the long-term. The possibility for a Global Invisible Hand is rooted in the notion that markets are dynamic social institutions.[92] Thus, at a certain point, China's intentional undervaluation of its

88. *See* Yu, *supra* note 6, at 597–98 ("Despite passing the Senate, the [Currency Exchange Rate Oversight Reform Act of 2011] received no attention from the House of Representatives and eventually died.").

89. *Id.*

90. Drezner, *supra* note 1, at 20.

91. *See* Beckington & Amon, *supra* note 36, at 267–68.

92. AMAN, JR., *supra* note 34, at 10.

currency against IMF agreements will eventually affect is ability to achieve other economic policy objectives.

Even though China has grown to the second largest economy in the world, it is still considered a developing economy.[93] According to Joseph Stiglitz, a recipient of the Nobel Prize in Economics, China is gradually shifting from an export-driven growth economy to a domestic services and household consumption economy.[94] Recently, China has even convinced the IMF to put the RMB on its list of world reserve currencies alongside the U.S. dollar, Pound Sterling, Japanese Yen, Euro, Swiss franc, and Canadian dollar.[95]

In response to the IMF recognizing the RMB as a reserve currency, China has made strides in liberalizing its economy and in allowing its currency to fundamentally realign with market forces.[96] Some take the inclusion of the RMB as a signal that China will play a more active role in global economic and finance issues.[97] However, the move by the IMF has also been met with stark criticism from the United States. Senator Bob Casey remarked that the IMF's decision did nothing but "validate China's history of cheating," while Senator Charles Schumer stated that the "IMF is choosing to reward China's currency manipulation instead of combating it."[98]

Nevertheless, it seems that China's future financial strategy includes increasing the use of the RMB as a reserve currency around the world. However, if China wants to keep the benefits associated with being a world reserve currency, it will have to shift its policies to adhere to its IMF obligations. Otherwise, the IMF could remove the RMB from its list of currencies, signaling to the world market that the RMB is inherently unstable. Thus, for China to solidify its new economic position, it will have to rein in its currency depreciation policies.

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93. *The World Bank in China*, THE WORLD BANK, http://www.worldbank.org/en/country/china/overview (last updated Mar. 28, 2017).

94. Joseph E. Stiglitz, *China's Bumpy New Normal*, PROJECT SYNDICATE (Jan. 27, 2016), https://www.project-syndicate.org/commentary/china-economic-policy-debate-by-joseph-e--stiglitz-2016-01?barrier=true.

95. Ian Talley, *China Joins World's Elite Currency Club: IMF's Decision to Make Yuan a Reserve Currency is Expected to Motivate Further Reforms*, WALL ST. J. (Nov. 30, 2015, 7:22 PM), http://www.wsj.com/articles/imf-lifts-chinese-yuan-to-elite-lending-reserve-currency-status-1448903067.

96. *Id.*

97. *Id.*

98. *Id.*

CONCLUSION

In conclusion, it is a myth that China's possession of 1.13 trillion dollars in U.S. debt will give the country the ability to influence United States policy at home and around the world. However, China's rise as a creditor nation has helped it regain its monetary sovereignty and has allowed the country to exert influence over global currency markets. The IMF's inability to prove and enforce violations under Article IV of its member obligations allowed China to undervalue its currency with no ramifications. As a result, China utilized its distinct trade advantage over other export-driven economies to grow into the second largest economy in the world. China's currency policies have produced global systemic risk as they create the incentive and the need for other exporting countries to depreciate their own currencies to stay competitive.

While jurisdictional hurdles exist, there is a real need to find an alternative means of enforcing potential currency violations under IMF Article IV. There are plausible arguments for the WTO Dispute Resolution Board to take jurisdiction over enforcement, but any solution will have little effect on China as member nations will be reluctant to confront the trading power for fear of economic retaliation.

In the end, the global market will act as a regulator to ensure that China does not fundamentally undervalue its currency. The "Global Invisible Hand" will correct China's currency policies because the global market and legal institutions that regulate it are the products of dynamic social processes. Eventually, China will transition away from an export-driven economy to establish itself as a lasting world power. By taking measures to liberalize its economy, China has been able to get the IMF to list its currency, the RMB, as a world reserve currency. This symbolizes China's emergence as a global economic power, but also implicitly assumes that China will not fundamentally undervalue its currency in the future.