How to Level the EU's Playing Field

Trade Remedies for a Trade Deal

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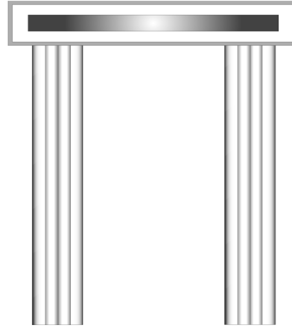

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PREFACE

Trade Matters!
Countering the Economic Costs of Coronavirus

Sheila Lawlor*

The Coronavirus has reaped its grim harvest, claiming hundreds and thousands of lives the world over and putting economies into lockdown. As governments restrict people's movement to stop the virus's spread, businesses have contracted or closed, and jobs have been put on hold or lost. Meanwhile, debt levels have risen as states and individuals borrow to cover the unprecedented lockdown. Not only have people suffered, as normal earnings cease and income levels fall, but whole economies have been weakened and trade too has suffered. Globally the economic toll will be heavy.

For the UK, a trading nation and the world's fifth richest economy, the virus poses particular questions. Not only must the country prepare for recovery and pay for the lockdown but it must put in place the building blocks for its future economic activity and legal framework for trade after the Brexit transition. Both tasks must be taken in tandem so that business and individuals have certainty to plan ahead and prepare for the future and so the whole economy is poised for recovery and to move to prosperity and growth as rapidly as possible.

The legal framework, now being negotiated for future trade with the EU, therefore matters. Not only will it matter for the UK's trade with the bloc and globally, but it also matters for the strength of the post-Coronavirus recovery and for the future UK economy outside the EU. Trade is one of the levers which allows the UK to play to its strengths as a competitive, entrepreneurial, free market economy under UK law: it will help to boost the opportunities for the economy to recover from the lockdown and return robustly to the world stage as a global economic player, its people prosperous, its businesses flourishing.

The pandemic and its consequences have highlighted two central matters for the UK which should be taken into account in the trade negotiations with the EU.

First, even during times of emergency, international trade law is robust: whatever the outcome of the trade talks, the UK's future trade with the EU and globally will be underwritten by clear and fair WTO rules. These rules and the dispute resolution mechanisms are proven. They cover many exceptional contingencies, including, for instance, current differences over whether a state should ban certain exports. In particular, the restriction on the export of protective face masks (used to slow down the spread of the virus) imposed by the US prompted criticism from a number of states. But WTO rules allow for the imposition of export bans in times of national emergency.

Indeed, there may be good reasons to allow a state legitimately to restrict certain exports (e.g. protective clothing or medical equipment) in the battle against Coronavirus. Many if not most citizens would object to their governments exporting equipment that could save lives at home, and it is wise to base international law, as well domestic law, on public consent. Once the pandemic passes, so will the emergency actions.

For goods trade therefore, the international rules are straightforward and contain proven arrangements for resolving disputes. They will govern UK-EU trade after the transition, irrespective of whether a UK-EU FTA is rapidly concluded. As David Collins has put it elsewhere, the WTO provides an umbrella

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under which states can shelter as they negotiate the best possible trade deals. *(Foundations of International Economic Law*, Elgar, 2019).

Second, for the UK in the Brexit negotiation, though news reports may focus on goods trade, there is another pressing problem to deal with, more important if less obvious and also highlighted by the Coronavirus emergency: the increase it may prompt in Eurozone debt to finance the crisis. Even before the pandemic, the EU's arrangements for managing debt and its currency could be seen to flout the Basel Rules, leading to significant debt and to the imposition of systemic risk on the world's markets, which was seen as problematic and was compounded by the stratagems and arrangements used to manage things, a point mentioned in Barnabas Reynolds' foreword and discussed by him and his co-authors in their recent publication. (*Managing Euro Risk: Saving Investors from Systemic Risk,* B. Reynolds, D. Blake and R. Lyddon, Politeia, 2020).

Whereas formerly the UK was powerless (as one member state amongst 28) to challenge the EU on such potentially damaging breaches of the international rules, it can now do so as it charts its future trade course for the sector and takes its own place at the WTO, resuming its seat as a founder member.

In this analysis David Collins suggests that such EU actions could be seen to be in breach of the international rules that aim to curb dumping through structurally low prices or through subsidising Eurozone exports. He discusses the potential remedies and explains that exports from the Eurozone may warrant anti-dumping or countervailing duties to counter unfair practices. But rather than levy such duties initially, on relevant EU imports, the UK could agree to suspend any systematic countermeasures provided that the EU agrees to a satisfactory FTA and concentrates on the redress of the most significant distortions. Nevertheless, the UK should not agree to a carte blanche for the EU or its Eurozone trade practices and must retain the right to take full action in the future.

In addition, Collins reminds us, currency matters need careful monitoring to ensure they are not used aggressively by states to gain the upper hand in trade over foreign competitors. For this reason he also proposes that future trade deals with the EU should include similar provisions to those in the US Mexico Canada Agreement (USMCA chapter 33) relating to currency manipulation.

The UK, therefore, should use its independence to fashion a deal that tackles such problems. For though the world's economies may be in lockdown, countries must prepare to recover and rebuild as the pandemic passes. The Coronavirus has already claimed almost 80,000 lives across the world, left families devastated and halted normal daily life because of measures to stop its spread. Now, as the UK battles to overcome its consequences, medical and economic, trading on the right terms will play a pivotal part.

Sheila Lawlor,
Director, Politeia
7 April 2020

Foreword - Legal Remedies for Legal Failings? The EU's Financial Sector, the International Legal Framework and the Future UK-EU Trade Talks

Barnabas Reynolds*

The EU's management of the Eurozone and its perceived failings and consequences have prompted a number of concerns which must be taken on board when the UK negotiates its future trade deal with the EU.

In particular, the EU's regulatory arrangements are inconsistent with the international Basel Rules in treating Eurozone member state debt as risk-free: that is because the EU rules wrongly assume that the debt is sovereign debt. Proper sovereign debt will always be repaid because the issuing government controls its central bank, enabling it to print more currency at will and repay its debts. But no individual member state, alone, controls the European Central Bank and none controls the management of the currency. Instead, Eurozone states rely on hoped-for cooperation from each other in agreeing to require the European Central Bank to print more money on their individual behalf. In addition, EU regulations and accounting rules buttress the flawed system in numerous ways, exacerbating the problem.

Moreover, in addressing shortcomings in the legal structure of the Eurozone, EU rules and regulations run contrary to normal regulatory practices in interfering with the ability of the market to operate freely on a day-to-day basis. They seek to control the market's perception of the value of debt in the Eurozone and do so in order to reduce the chances of Eurozone member states having to step in to bail each other out.[1] The Eurosystem then leverages up the member fiscal and banking system by acquiring member debt and bad assets in vast quantities. The European Central Bank plays a central role in buying up the debt and assets, but this achieves only a partial debt mutualisation and masks the Eurozone's failure to provide for the proper mutualisation of Eurozone member state debt, risking hyperinflation and a significant reduction in the value of the debt in the process.[2] These arrangements, which bend the fundamental legal building blocks of a free market, give the Eurozone states an unfair competitive advantage in managing the level of their currency. They result in the misapplication of the Basel Rules which in turn results in the Eurozone financial system being undercapitalised, undercollateralised and illiquid. As a result, the UK's Bank of England takes steps to protect the UK system and compensate by requiring more top-up, loss-absorbing capital for global financial institutions incorporated in the UK.[3] Meanwhile, Eurozone banks themselves are not required to address their own risk by similarly issuing top-up capital, thereby operating in the global market at a competitive advantage. The result is the Eurozone is operating at the rest of the world's expense.

Yet, the Bank of England's ability to continue this protection in its current form will cease at the end of this year. Now, to tackle the problem of risk after the transition, the EU must, after the UK's move out of the EU's regulatory regime at the end of 2020, accept new financial services trading arrangements with the UK. These should acknowledge the financial risk the Eurozone creates for investors and savers around the world and ensure jurisdiction for the UK properly to mitigate this risk on behalf of the global financial markets which it hosts.

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[1] Such steps include EU regulations allowing the control of credit ratings of Eurozone government debt, controlling the haircutting of Eurozone government bonds by clearing houses, offloading the risk of bank default from local Eurozone taxpayers onto the global markets and allowing banks to treat non-performing loans as partially performing without a renegotiation of that debt.

[2] These points and the legal, financial and economic implications are considered in *Managing Euro Risk: Saving Investors from Systemic Risk*, by Barnabas Reynolds, David Blake and Robert Lyddon, Politeia, 2020.

[3] The Bank of England within the EU framework has managed to mitigate Eurozone risk for the global markets and the UK through the application of stress tests and the imposition of discretionary loss-absorbing capital requirements for UK-incorporated financial institutions which have been conducting most EU financial business cross-border from the UK.

Next, the euro is undervalued for some member state economies, structurally reducing the price of their exports; yet those member states are not 'paying' for the currency by putting their balance sheets at risk, standing jointly and severally behind the fiscal arrangements that underpin the currency they benefit from. Further, the Eurozone's TARGET2 system provides essentially unlimited support for Eurozone producers by providing loans to their Eurozone-based buyers, thereby subsidising those producers and facilitating the dumping of their products at artificially low prices on the world markets.

To tackle the consequences of dumping and subsidising artificially cheaper goods, David Collins' analysis considers relevant international trade law and how the remedies it provides for could be deployed. It explains how the WTO's anti-dumping laws operate and how in certain cases tariffs can be applied if WTO members engage in the dumping of underpriced products. It also explains the WTO's rules relating to unfair subsidisation of Eurozone industries. These enable counterparty trading nations around the world to impose countervailing duties to remediate the situation. In both cases, WTO law provides for these self-help mechanisms to rectify the improper trade distortions that arise.

Such remedies should now be embraced by the UK talks team to shape UK-EU future trade. Not only should the UK recognise that the mind-set of the EU (and of those UK parties who opposed leaving the EU) is like that of an 800 pound gorilla facing an unequal adversary, but it should resist this thinking and not permit the EU's legal mind-set to exert intellectual capture. The EU is not in law operating fairly on the global markets. It is dumping financial risk as well as goods, and unfairly subsidising its produce. There is no reason for the UK to accept EU law or be bound by EU courts or accede to the EU's proposals for level playing field arrangements. The UK should instead make clear that EU law and the Eurozone system can lead to significant trade distortions.

The problems cannot be made to disappear merely by the signing of a UK-EU Free Trade Agreement which fails to tackle such problems since, by their nature, these issues are long-lasting and structural. Indeed the situation needs to be viewed in the global context and other countries' concerns are likely also to come to the fore as the UK examines its future global trading priorities afresh. In fact the US for some time has been troubled by various states' trading practices, including those of the EU, seeing them as unfair to the US, although there has been no apparent appreciation so far of the structural legal flaws and advantages conferred by the Eurozone in that US bank stress tests have not identified or sought to address Eurozone risk.

Future EU trade for the financial sector with this country and the risk it carries should continue to be managed under UK law. This requires a financial services agreement to be put in place as part of the deal under which UK-based businesses continue to provide services across the EU but under UK law and the oversight of UK regulators. The UK would operate autonomously in legislating, regulating and supervising on the traditional common law method, undertaking only to observe the high level standards in the Basel Rules with provision to accommodate Eurozone member debt for an initial period while the Eurozone decides the extent to which it wishes to continue on its path to integration, after which the fixed term accommodation would cease to operate. In this way the EU's trading counterparties – including, for the first time, the UK – would be put as close as possible into the position which under international financial regulations they should be in if the Eurozone's structures had, in the first place, properly implemented them.

At the same time, the UK must ensure the potential for financial adjustments to UK-EU trade through the application by the UK, US and others of tariffs and duties to impose a true 'level the playing field' on EU trade.

As the UK engages with the EU on the shape of future trade, it must now recognise that the EU's deployment of its own legal structures - often without taking adequate account of the international rules - as an instrument of competitiveness has operated to the detriment of its trading partners around the world. Fair competition requires international law to be applied properly.

Barnabas Reynolds, Partner, Head of Financial Institutions, Shearman & Sterling LLP, 7 April 2020

THE AUTHOR

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I

Regulatory Parity?
The Real Problem

The European Union has proposed that the UK should conform to many aspects of EU law post-Brexit to create a 'level playing field' between the UK and EU as a condition of concluding a Free Trade Agreement (FTA).[1] While there is validity in maintaining regulatory parity between trading nations in order to reduce non-tariff barriers, international law provides a better route to regulatory parity than the laws of one regime. Much can be achieved by the global community through international standards on trade. Such standards include not only health and safety rules on goods, but also a regime for the control of unfair subsidies and dumping of low-priced goods into foreign markets. Since regulatory competition in trade is addressed amongst the 164 members of the World Trade Organisation (WTO), including the EU itself, based on frameworks in place since the foundation of the international law trading system in 1947, adherence by the UK to EU law is not necessary. Besides, it would go beyond the normal conditions found in most trade agreements, including those of the EU.

There are, however, important matters for the UK to address which arise from the EU's potential breach of international rules if regulatory parity between is to be achieved for an FTA.

In particular, evidence suggests that an unfair advantage exists, not for the UK but for the EU as a result of its management of the euro currency for which the UK, and the rest of the world, suffer. It is therefore the UK and other WTO members who need to secure an EU 'level playing field' because the legal arrangements under-pinning the euro have created an unbalanced set of circumstances, according an advantage to EU exporters to the detriment of their international competitors.[2]

Under the Treaty on the Functioning of the European Union (TFEU, Art 128) the European Central Bank (ECB) has exclusive right to authorise the issue of euro banknotes.[3] This legal framework applies to the nineteen Eurozone (EZ) states of the EU's 27 member states.[4] These 19 states therefore have ceded control of the money supply to the ECB. This means that these states comprising the EZ are no longer – in law – sovereign. Yet EU law treats members of the EZ as though they were still sovereign, creating a cascade of consequences:

- The EZ's member states can finance themselves by raising significant debt to provide internal financing to customers of EZ businesses – without the EZ taking full sovereign liability for the

[1] 'Directive for the Negotiation of a New Partnership with the United Kingdom of Great Britain and Northern Ireland' Council of the European Union (25 February 2020) which refers to the 'level playing field' at [17] [19] [20] [66] [74] [78] [81] [94] [95] [106]. <https://www.consilium.europa.eu/media/42736/st05870-ad01re03-en20.pdf> (accessed March 2020)

[2] See Barnabas Reynolds, David Blake, and Robert Lyddon, *Managing Euro Risk*, Politeia, 27 February 2020 for discussion of how this arises. See also, B Reynolds, "EU-managed control of euro clearing is not viable", B. Reynolds, Financial Times, 15 May 2017; B Reynolds, "UK Safer For City's Financial Sector Than EU" Politeia, 2 May 2017.

[3] Art 128 TFEU says: "1. The European Central Bank shall have the exclusive right to authorise the issue of euro banknotes within the Union. The European Central Bank and the national central banks may issue such notes. The banknotes issued by the European Central Bank and the national central banks shall be the only such notes to have the status of legal tender within the Union. 2. Member States may issue euro coins subject to approval by the European Central Bank of the volume of the issue. The Council, on a proposal from the Commission and after consulting the European Parliament and the European Central Bank, may adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Union."

[4] The member states in the Eurozone are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain. Denmark opted out. Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania and Sweden are not in the Eurozone. The UK, while it was an EU member, also opted out of the euro.

result. This leads to the injection of phenomenal systemic risk into the global financial system. In other words, the EZ has been running a currency it is not fully paying for.

- Whatever the internal equilibrium achieved between EZ member states, the resulting currency value could provide a structural trading advantage to many of its producers. The euro's relative undervaluation – mainly for the northern member states such as Germany and the Netherlands – benefits EZ exporters.
- These arrangements could allow for unlimited financing and other financial support to the customers of EZ sellers, through internal inter-state lending and other arrangements, including TARGET2, which settles payments related to the EZ's monetary policy operations, as well as bank-to-bank and commercial transactions. This is all despite the member states which back those seller-producers not fully underwriting the fiscal arrangements from which they benefit.

The results are observable and involve what might be considered legally invalid, significant and persistent structural international trade surpluses being achieved by certain EZ states. Given the implications of such structural imbalances the UK should now take account of such arrangements in approaches to future EU trade relations following its departure from the EU.

This paper accordingly examines:

I. How WTO law and International Monetary Fund (IMF) rules mean that the UK and other WTO members are entitled to respond to the unfairness of the EZ under international law

II. How the UK could apply tariffs or duties to compensate for the detrimental financial effects of the EZ's set-up

It argues that UK firms, as with those in other countries, are being harmed by the EZ structure which accords an unfair advantage to EU-based firms, enlarging their competitive capacity in international trade, suggesting potential trade remedies available under international law. It further outlines what the UK, and by extension other WTO members, should be seeking in any future trade deals with the EU to minimise this problem.

Drawing immediate attention to the trade-illegality of the EZ, coupled with forbearance on the remedial actions discussed herein, could operate as effective leverage in FTA negotiations with the EU. However, this should not distract from the need to create a fair and level playing field for future trade so that the UK is not effectively underwriting the EZ's success and the EZ states are required to compensate, in the form of higher tariffs, for the system they have chosen to create.

II
Breaches of International Law

There are three spheres of international law which are potentially breached by the EZ set-up as described above. The first two are covered by WTO disciplines on dumping and subsidies and the third relates to the rules of the IMF. Remedial actions are available to other WTO member states, consisting of anti-dumping duties, countervailing duties and a claim for impairment of benefits pursuant to the General Agreement on Tariffs and Trade (GATT).

WTO Disciplines: Dumping and Subsidies

Currency manipulation – detrimental to international trade?

Currency manipulation is generally regarded as being outside the remit of the WTO on the grounds that all states need the ability to manage their economic policy and because any ensuing trade distortions in terms of cheaper exports tend to be offset by those on more expensive imports.[5] However, there is a forceful argument to be made that the kind of currency manipulation embedded in the euro's structure is precisely that which is contemplated by WTO disciplines because of its strong detrimental impact on international trade, specifically the competitive opportunities of firms in countries such as the UK. Chief among WTO rules which are engaged are those relating to dumping, or more specifically the regulation of anti-dumping.

Dumping through structurally low prices

Article VI of the GATT explains that dumping occurs when products of one country are introduced into the commerce of another country at less than the normal value of the products. This is harmful to firms in the importing state because they cannot withstand the foreign competition and tend to lose market share, eventually disappearing entirely, allowing the foreign firm to take hold of the market and sell at monopolistic prices.

Countries may act against this practice through the imposition of duties against the relevant products if the dumping causes or threatens material injury to an established industry or materially retards the establishment of a domestic industry. The evidence needed to prove that dumping has occurred must establish that the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.[6] In the context of the EU, the exporting country is the EU as a whole, meaning any of the member states. The evidence needed to demonstrate injury resulting from the dumping involves an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producers of such products.[7]

The euro's artificial undervaluation results in dumping because the price of EU-produced goods ends up being lower abroad because of exchange rates with the pound, the US dollar and other currencies which are valued accurately. In other words, goods produced in certain EZ member states, especially Germany, are unnaturally cheaper on world markets than they should be. This unfairly advantages exporters from these countries. Additionally, the EZ maintains internal financing arrangements with low interest rates, providing buyer support within the EZ and therefore indirect support to EZ sellers.

[5] R Steiger and A Sykes, Currency "manipulation" and world trade: A caution , VOX CEPR Policy Portal, 30 January 2009.
[6] Anti-Dumping Agreement Art 2.1.
[7] Anti-Dumping Agreement Art 3.1.

These sellers are therefore able to sell their products at artificially low export prices to purchasers non-EU countries, another arguable manifestation of dumping. While the foreign purchasers may enjoy access to cheaper goods, foreign suppliers are disadvantaged.

Mindful of eventualities like this, footnote 2 to paragraphs 2 and 3 of GATT Article VI states that currency practices can in certain circumstances 'constitute a form of dumping by means of a partial depreciation of a country's currency.'

To be sure, dumping is normally seen as something which is practised by firms, not states. Firms offer their goods at lower prices abroad than at home with a view to eliminating effective competition in that foreign country over time. However, there is nothing in the GATT or the WTO's Anti-Dumping Agreement (ADA) indicating that private companies are the only actors which may be involved in dumping practice. Issues beyond the exporting firm's activities can also contribute to international price discrimination, such as, for example, governmental assistance in the form of direct subsidies or, in the case of the undervalued EZ, artificially low export prices. Furthermore, anti-dumping investigations focus only on whether there is a lower export price, not how the lower price is achieved. They do not exclude circumstances where currency undervaluation or internal EZ arrangements such as TARGET2 are the cause of the lower price.

The set-up of the EZ may also be characterized as an unfair subsidy of certain exports. Southern EZ countries are indirectly subsidising German and other particularly northern EZ state exports, not only by producing low cost components made by workers on falling real wages, but also by dragging down the international value of the euro and through the provision of financing for sales within the EZ by those producers. Various aspects of this arrangement as they relate to international trade may be actionable under WTO rules.

The WTO's Rules - Artificially low currencies, subsidies and price advantage

There is extensive and persuasive commentary on the possibility that artificially low currencies could amount to a subsidy and therefore violate the WTO's Agreement on Subsidies and Countervailing Measures (SCM).[8] It is no surprise that the US Department of Commerce recently announced that it intends to impose countervailing duties on products which benefit from unfair currency subsidies.[9] The price advantage conferred by currency undervaluation, as in the case of the euro, resembles a subsidy in many respects. A similar point arises for buyer financing within the EZ.

The evidence needed to establish that a subsidy exists is outlined in Article 1 of the SCM which specifies that a subsidy exists if:

(a) there is a financial contribution by a government or any public body;

(b) a benefit is thereby conferred; and

(c) the subsidy is specific to an enterprise or industry or group of enterprises.

It might be debated whether currency manipulation, such as practised through the use of the euro by Germany in particular, would satisfy the 'specificity' requirement because, while the undervalued euro may benefit the automotive sector most of all, it is an advantage conferred to the entire sub-economy

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8 E.g., A. de Lima-Campos and J. A. Gaviria, 'A Case for Misaligned Currencies as Countervailable Subsidies' 46 Journal of World Trade 1017 (2012) and B. B. Caryl, 'Is China Currency Regime a Countervailable Subsidy? A Legal Analysis Under the World Trade Organization's SCM Agreement', 45 J. World Trade 187-219 (2011).

9 US Department of Commerce, 'Department of Commerce Issues Final Rule for Countervailing Unfair Currency Subsidies', 4 February 2020; https://www.commerce.gov/news/press-releases/2020/02/department-commerce-issues-final-rule-countervailing-unfair-currency.

(for instance a particular EZ state) rather than a specific enterprise or industry. Nevertheless, some commentators hold that an undervalued exchange rate constitutes an export subsidy and is therefore deserving of retaliation, as will be discussed further below.[10] This is, in part, predicated on the notion that if a subsidy is provided for the purposes of augmenting exports, it is deemed to be specific to all those benefitting, in accordance with under Article 3 of the SCM, meaning that the benefit need not be conferred on a particular enterprise or industry. This may be contrasted with non-export related subsidies where specificity must be demonstrated.

More obviously, large suppliers within the EZ, especially manufacturers in Germany, enjoy a competitive advantage vis-à-vis their foreign competitors because their buyers obtain tax-supported financing, as alluded to above. This enables these firms to access cheaper financing than available to other suppliers on the open market. Such governmental assistance arguably fits within the definition of subsidy in the SCM under Article 1 as a 'form of income or price support' and also as a 'direct transfer of funds' which yields a benefit which would not be available under normal market conditions – i.e. access to financing at artificially low interest rates. This subsidisation is further likely to satisfy the 'specificity' requirement of Article 2 of the SCM because the granting authorities, in this case the financing institutions within the EZ, explicitly limits access to these advantages to 'an enterprise or industry or group of enterprises or industries' – in this case an identifiable number of buyers of products from German and other manufacturers. In the language of Art 2.1c) this constitutes one or more of: 'the use of a subsidy by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises and the manner in which the discretion has been exercised by the granting authority in the decision to grant a subsidy.' WTO case law suggests that the concept of 'industry' here is to be broadly construed, covering situations where a diverse array of goods are produced.[11] This appears to be precisely the situation which exists in the EZ.

IMF Rules - Exchange Rates, Balance of Payments

Breach of IMF rules

In addition to possible breaches of WTO law, there are two facets of IMF rules which appear to be violated by the EZ, the second of which leads to particularly negative potential consequences for the rest of the world.

- *Exchange Rate Stability.* The undervalued euro could breach Germany's and certain other EZ states' (such as the Netherlands') obligations as a member of the IMF, specifically Article IV(1)(iii) of the IMF's Articles of Agreement which prohibits IMF members from manipulating their currency for the purposes of gaining an unfair advantage in trade. The effectiveness of this provision is somewhat limited given that, unlike the WTO, the IMF lacks a dispute settlement system or enforcement mechanism. Still, Article XV of the GATT requires all WTO members to co-operate with the IMF with regard regards to currency exchange and valuation issues. This obligation is also a rather tenuous obligation in terms of its practical legal consequences. The GATT, like all WTO rules, is enforceable through the WTO's Dispute Settlement System, mandating the removal of the illegal measure, in this case the artificial currency.
- *Balance of Payment Obligations.* The financial risks inherent in the EZ may further be characterised as a balance-of-payment problem. Without the freedom to adjust nominal exchange rates between EZ member states, inflation in Germany and deflation elsewhere in the

[10] A. Mattoo and A. Subramanian (2009), 'Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization', The World Economy, 32: 1135–1164 (2009).

[11] United States – Certain Softwood Lumber from Canada (WT/DS257/R) Panel Report, 17 Feb 2004.

EZ is required to balance the EZ economy by changing the real exchange rates between member states. Several EZ member states maintain significant current account deficits, e.g., Spain. Such states are at permanent risk of defaulting on their borrowings, unable to raise capital as if they were sovereign. In order to maintain balance of payments equilibrium across the EZ, as required by the IMF under Article IV(1)(iii), Germany engages in a capital account transfer to the indebted nations on a regular and ongoing basis – as happens in unitary and fully federal states, like the UK and US, respectively. In the euro context, this is not a 'foreign' exchange deficiency, but one within the EZ. Greece, and several other EZ countries, have a balance of payments disequilibrium, relying on Germany to provide the capital to bail them out. The EZ is at constant risk of a significant internal balance of payment crisis because of its fixed nominal exchange rates. This predicament is relevant to international trade because Article XII of the GATT permits WTO members to engage in trade protectionism in order to ensure a balance of payments equilibrium. This may be achieved in the form of import restrictions (quotas), also known as safeguards. India levied such restrictions on agricultural products based on maintaining its balance of payments equilibrium, despite objections from the EU and the US.[12] The frailty of the EZ therefore means that each of the EU's trading partners is in very real danger of facing such trade barriers at some point in the future in the form of quotas or harmful tariffs on a range of products. Worse, if they are no more onerous than necessary to address the EU's balance of payment difficulties, such safeguards cannot be challenged. Any attempt to levy retaliatory tariffs would be prohibited under WTO rules.

[12] India — Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/AB/R (23 August 1999)

III

Violating International Law – The Remedies Anti-Dumping and Countervailing Duties

Considering the features of international law described above which the EZ structure may violate, there are various options which may be available to the UK and other WTO members to remedy the situation. Two such remedies will be discussed here – each involves the levying of tariffs on dumped or subsidized imports. These are anti-dumping duties, which allow the injured party to impose a duty on the import to bring it to the price it would have been without the intervention, and countervailing duties, which can be set at the level of what the subsidy is estimated to be, also approximating what the price of the import of the good would be without the subsidization. In addition, it should be noted that competitive currency devaluation also breaches IMF rules. Although no formal remedy for breach of IMF rules exists and the IMF lacks a dispute settlement or enforcement mechanism, certain procedures could come into play in respect of WTO Members' obligation to cooperate with the IMF on currency exchange rates as outlined in Article XV of the GATT.

Choosing among these three remedies will depend on which UK firms are harmed by EZ imports and in what way as well as the nature of the evidence which is available to establish the causal link to EZ currency practices.

How to Tackle Trade Distortions

Anti-Dumping Duties

Under the WTO's Anti-Dumping Agreement (ADA), the injured party can take unilateral action (ie without multilateral consensus) to remedy the position.

Where dumping is held to exist pursuant to the rules laid out in the ADA (requiring verification by domestic trade remedies authorities in each WTO member) in which prices in the domestic market are compared to those in export markets, the injured WTO member (in this case the UK) would be allowed to impose anti-dumping duties (retaliatory tariffs) on the relevant imported goods up to the amount of the dumping. Such tariffs are intended to approximate the actual price of the good. The application of anti-dumping duties to German exports, for example, is justifiable because the WTO's primary concern is not the existence of currency manipulation itself (recall this not unlawful under WTO law), but the trade distortion effect caused by the lower export price which results from it and from the EZ's internal (buyer financing and other) arrangements. The spirit of the ADA is consistent with such an understanding, which is not to categorically prohibit dumping but to allow the injured member to take actions against those causing or threatening material injury to its domestic industries. Many thousands of anti-dumping initiatives have been pursued on this basis over the past several decades both under WTO (and GATT rules) as well as similar regimes contained in FTAs.

Anti-dumping duties may therefore be levied against products which have been dumped in order to normalise their price. Already the UK has made clear that it seeks to uphold the 'lesser duty' rule, in its future trade relations with the EU,[13] which specifies that the quantum of the anti-dumping tariffs need not establish the precise level of the normal value of the product if a lesser amount will fully compensate for the injury which has been inflicted. The surrogate price method outlined in Article 2.2 of the ADA may be appropriate to calculate the dumping 'margin' created by the EZ for each product. Under this method, the normal value of the product is assessed by reference to what it is in a third country which

[13] The Future Relationship with the EU: The UK's Approach to Negotiations (February 2020) Art 4.9.

is not a currency or financing manipulator, instead of by simple comparison between the domestic and the imported price of the good. The simple comparison method would clearly be inadequate to measure the structural advantage achieved by those EZ member states benefitting from this arrangement and would be an inadequate remedy since the euro currency masks the advantage seeking to be determined. Instead, the surrogate price method for calculating dumping margins is the most appropriate for the EU since the structure of euro currency undermines the EU's status as a genuine market economy. There is no identifiable 'normal value' of product's domestic price because of the nature of the euro itself.

The surrogate price methodology was originally intended to cover dumped products originating in non-market economies like China, not ostensibly market-oriented ones like the EU. The logic for special non-market economy treatment is based on the presumption that excessive state interference in the economy renders domestic prices so misaligned with supply and demand that they cannot serve as a legitimate benchmark for export prices. China is, or was, considered a non-market economy under WTO rules, because the view has been taken that establishing a 'normal' price in its domestic market is impossible. In such circumstances, products suspected of being sold by China at an unfair price can be assessed by the price of the same product from a third country where the product is manufactured at a 'normal' market rate – a surrogate price.

If a suitable third country cannot be found by which to assess the normal value of the dumped product from the EZ, there is an alternative 'constructed' value method specified in Article 2.4 of the ADA for assessing dumping margins. In this method, the country conducting the dumping investigation hypothesizes what the normal price in the domestic market should be based on the cost of inputs as well as administrative and selling expenses allowing for reasonable profits. However, this methodology could get complicated because it would involve an elaborate counterfactual hypothesis assessing how much the euro should truly be worth in Germany (and other beneficiary states) in terms of what it could buy, which might be equated with the historic Deutschmark (and other legacy member currency) were it still to exist. It would also involve assessing the price of products without the EZ member-state-sponsored financing arrangements. Furthermore, it will be difficult to find the evidence for the true cost of inputs in the EZ. The constructed value method is very rarely used because of these complexities. It is associated with situations where there is a special relationship between the importer and the exporter, yielding uncertain pricing evidence. For example, it was used against Russia by the Ukraine in 2019[14] because the cost of energy inputs in Russian goods was artificially low because the price of energy was regulated.

Countervailing Duties

The UK could impose countervailing measures for evidenced unfair subsidisation resulting from the structurally undervalued euro and the unfair seller/exporter financing arrangements, imposing duties on the relevant products to counterbalance the subsidization, known as 'countervailing duties.'

Where a WTO-illegal subsidy is found, the offending member is required to remove the subsidy immediately. There is no requirement for the advantaged firm to 'pay back' the subsidy. It is hard to envisage how the EU could cease engaging in this form of subsidy to its firms since the entire architecture of the EZ is predicated upon it, which is precisely why countervailing duties would be necessary. If the offending WTO member fails to remove the subsidy, those countries which have been injured by it (with injury presumed in the case of export subsidies) are authorised to impose countervailing duties equivalent to the level of the subsidy to offset the harm suffered. The quantum of the subsidy is ascertained by reference to the benefit received by the relevant firm within the domestic

[14] Ukraine — Anti-Dumping Measures on Ammonium Nitrate, WT/DS493/AB/R (12 September 2019).

economy of the subsidising state.[15] The magnitude of such duties in the context of the euro across the entirety of the EZ economy and all of the affected manufactured goods would be enormous.

The EZ's effective status as a non-market economy because of the euro is also relevant for the purposes of establishing the *level* of countervailing duties calculations on each product originating from within the EZ in the case of subsidies. In this regard, China's WTO Accession Protocol of 2001 specifies: 'if there are special difficulties in [the application of the SCM to China], the importing WTO member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks'. This suggests that the normal definition of a subsidy outlined in the SCM may be expanded in the case of the EZ, covering 'benefits' which go beyond those associated with market economies, e.g., the government forgoes revenue which it is owed or it transfers funds directly to the firm. To ascertain the existence of such benefits, it may be appropriate to compare EZ-based firms with similarly placed ones in market economies in terms of the economic conditions in which they operate as broadly construed.

Impairment of Benefits Associated with the Duty of Cooperation with IMF

As indicated above, there is no formal remedy for breaches of IMF rules, including those on currency manipulation. So there is limited practical relevance attached to breach of IMF rules given that, unlike the WTO or FTAs, the IMF lacks a dispute settlement system or enforcement mechanism. IMF members can have their voting rights suspended or, in extreme cases, they can be expelled from the IMF. However, any such step is normally taken due to persistent non-payment of IMF loans rather than the maintenance of an artificial currency. Regarding the obligation to cooperate with the IMF on currency exchange rates outlined in Article XV of the GATT, there is limited practical relevance in terms of authorising retaliation through WTO procedures for breach of this obligation. Were such a violation to be found, this could permit the suspension of equivalent negotiated trade concessions (tariff reductions) if the illegal measure is not removed in a timely fashion, or retaliatory tariffs. It would be exceedingly difficult to calibrate the extent of the lawful retaliation as a response to the EU's non-cooperation with the IMF on currency exchange matters through the euro. There have been no cases in which remedies have been authorised by the WTO based on a breach of this provision of the GATT. Still, this does not mean that such a claim would be impossible. In fact, the significant trade distortions arising from the EZ regime could be an appropriate situation to call for use of Article XV, perhaps in conjunction with the SCM or the ADA. Commentators have suggested that Article XV may be violated indirectly where the intent of another provision of WTO is breached, such as for example the dumping or subsidies disciplines.[16] In this way the duty of cooperation with the IMF may bolster the arguments in favour of the EZ regime as constituting dumping or an illegal subsidy, even if Article XV may not be breached.

[15] Agreement on Subsidies and Countervailing Measures Art 14.

[16] See e.g. J Trachtman, International Economic Law and Policy Blog (20 April 2010).

IV

Negotiating a UK-EU Free Trade Deal Redressing Eurozone Violations

In the current trade talks between the UK and the EU, the extent to which the UK will be able to secure a favourable outcome may depend on the leverage which it has against the EU in various spheres of economic activity. One way to secure such leverage would be for the UK expressly to draw attention to the unfairness intrinsic in the euro for EZ based exporters. The UK should make clear it intends to levy duties on significant imports which benefit from to remedy EZ trade distortions, but will, subject to a satisfactory trade deal, concentrate any redress on the most significant distortions resulting from time to time on particular products.

The UK government introduced a Trade Bill in March 2020[17] which established a new domestic Trade Remedies Authority to prevent countries from dumping cheap goods onto the UK market and to guard against foreign subsidization and illegitimate use of safeguards, potentially putting domestic industries, like steel, out of business. The Trade Remedies Authority will enable the UK to conduct its own dumping and subsidies investigations, which had previously been done by the EU Commission and then levy them on the relevant international goods, as appropriate. It is important to recognize that anti-dumping duties and countervailing duties amount to the same thing – they are additional tariffs imposed on the imported product. Together, anti-dumping and countervailing duties have been imposed widely around the world. Indeed, an estimated 4% of all US imports are subjected to trade remedy tariff as of 2019.[18]

This paper has suggested that exports from within the EZ may warrant anti-dumping duties and/or countervailing duties, reflecting benefits accorded through the EZ's interventions on the value of the euro and related support provided by government authorities within the EZ. The UK and other WTO members could consider committing not to *automatically* levy anti-dumping or countervailing duties against a broad range of exported products from the EZ because of the trade imbalances arising from the EZ indicated herein, but instead (subject to a satisfactory FTA being in place) to concentrate any redress on the most significant distortions resulting from time to time on particular products. This restraint could operate as a bargaining chip in FTA negotiations between the UK and the EU. The UK should not of course agree a *carte blanche* for EZ trade practices and will need to retain the right to take action in the future and indeed should do so where the effects are detrimental to UK businesses.

It is often thought that the trade remedies described in this paper were not designed to redress structural issues such as currency manipulation and its harmful effects on international trade. However, this uneasy fit may be linked more to practical difficulties in quantifying trade distortions rather than the meaning or purpose of these aspects of WTO law which evidently contemplate this kind of unfair practice, even if the direct supervision of exchange issues is the purview of the IMF. Currency issues clearly require careful monitoring to ensure that they are not being used by states aggressively to gain the upper hand in trade over foreign competitors. This is precisely why future FTAs with the EU should include material like that found in Chapter 33 of United States Mexico Canada Agreement (USMCA) relating to currency manipulation. This chapter affirms the parties' commitments to IMF obligations relating to currency stability but also requires parties to make monthly disclosures regarding exchange rates and balance of payments data. It also mandates the establishment of a committee that meets

[17] Bill 120 2019-21

[18] C. Brown and S. Keynes, 'Why Trump Shot the Sheriffs: End of WTO Dispute Settlement 1.0' PIIE Working Group Paper 20 (4 March 2020).

annually to review exchange rate issues between the parties. In the case of UK-EU trade the committee should also consider the effect of EZ financing practices on trade. It appears, at least in the case of the USMCA, that this provision is largely symbolic because there are no indications that any of the parties to that FTA is engaging in competitive currency devaluation. It was included at the behest of the US as a pre-emptive declaration of its refusal to countenance exchange rate manipulation as a trade barrier. In the UK-EU FTA, however, these kinds of commitments would effectively place the EU on notice that the UK is taking the currency manipulation effects of the EZ set-up seriously and the committee could work as a forum through which pressure is placed on the EU either to reform the euro's legal order or to make continuing compensatory payments to redress the unfair imbalances it currently creates.

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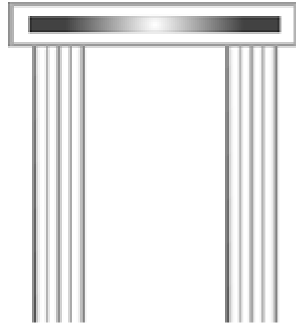

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