NOTES

INTERNATIONAL TRADE LAW CONCERNS WITH CHINA'S DIGITAL CURRENCY: HOW SOVEREIGN-ISSUED STABLECOIN CAN DESTABILIZE INTERNATIONAL TRADE

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Abstract

China's introduction of a new central bank-issued digital currency named the DCEP (Digital Currency/Electronic Payments) advances the government of China's (GOC) goals to internationalize its currency, the renminbi, and to expand government oversight over China's economy. However, the unique features of digital currency that help advance the GOC's goals may also tempt the GOC to violate World Trade Organization (WTO) agreements such as the General Agreement on Tariffs and Trade of 1994 (GATT) and General Agreement on Trade in Services (GATS). As the concomitant issuer of the renminbi and the renminbi-collateralized DCEP, China's central bank, the People's Bank of China (PBOC), will exercise inimitable monetary and economic control. A government-backed digital currency will grant China unprecedented trade leverage and, if China chooses, help the GOC conceal actionable subsidies and manipulate its currency exchange.

In addition to allowing the GOC to exercise more control over its economy with the DCEP, the characteristics of digital currency will permit China to prolong the appearance of increasing marketization and liberalization of its economy. The DCEP will allow China to loosen regulations and argue that it is creating a fairer playing field for trade when, in fact, the DCEP grants China incredible authority to manipulate international trade. The WTO is unprepared to deal with the unique challenges posed by a central bank-issued digital currency, especially in China where domestic banks are mainly state-owned.

This Note analyzes how China's digital currency will affect its status in international trade. Part I briefly summarizes cryptocurrency and stablecoin, defines China's DCEP as stablecoin, and offers a comparison to Venezuela's stablecoin

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with a brief aside on the GATS implications of stablecoin. Part II briefly discusses why China wants to use stablecoin and establishes how the use of stablecoin to advance the GOC's goals of increased oversight over the Chinese economy and of internationalization of the renminbi begets international trade issues.

Parts III through V address international trade concerns around the digital currency. Part III discusses how the DCEP may affect China's status as a non-market economy (NME) in relation to anti-dumping laws. Part IV discusses how the DCEP may help China conceal actionable subsidies while creating an appearance of less state control over Chinese industries. Part V examines China's current lending crisis and how the DCEP impacts lending controls and could facilitate actionable subsidies through China's lending industry. Part VI discusses the practical and immediate effects of the DCEP and provides a brief conclusion on how the potential adverse effects of DCEP on fair trade can be addressed and mitigated by the WTO and WTO members.

I. INTRODUCTION

A. *What is China Doing with Digital Currency?*

The government of China (GOC) plans to launch a digital currency entitled the DCEP (Digital Currency/Electronic Payments).[1] The People's Bank of China (PBOC), China's central bank, will issue the DCEP and initially extend the digital currency to commercial banks.[2] In April 2020, the PBOC initiated limited pilot testing for the DCEP in four large Chinese cities: Shenzhen, Suzhou, Chengdu, and the Xiong'an New Area near Beijing.[3] Following additional testing, the PBOC hopes to launch the DCEP in time for the 2022 Winter Olympics in Beijing.[4]

Eventually, China could use the digital currency for ordinary transactions, payments, and currency exchange. China already leads the world in online payment systems; eighty-two percent of Chinese adults used

1. *See* Yaun Yang & Hudson Lockett, *What is China's Digital Currency Plan*, FIN. TIMES (Nov. 25, 2019), https://www.ft.com/content/e3f9c3c2-0aaf-11ea-bb52-34c8d9dc6d84. For supplementary background analysis of the DCEP, see Sundee Gantori, Yifan Hu, Hyde Chen, & Kathy Li, *Information Technology Understanding China's Digital Currency and Blockchain Initiatives*, UBS CHIEF INV. OFF. GWM (2020) (providing supplementary background analysis of the DCEP).

2. *See* Brenda Goh & Samuel Shen, *China's Proposed Digital Currency More About Policing than Progress*, REUTERS (Nov. 1, 2019), https://www.reuters.com/article/us-china-markets-digital-currency/chinas-proposed-digital-currency-more-about-policing-than-progress-idUSKBN1XB3QP; *see also* Michael, *China's National Digital Currency DCEP/CBDC Overview*, BOXMINING (June 23, 2020), https://boxmining.com/dcep/#DCEP_will_operate_on_a_twotiered_system.

3. *See* Jonathan Cheng, *China Rolls Out Pilot Test of Digital Currency*, WALL STREET J. (Apr. 20, 2020), https://www.wsj.com/articles/china-rolls-out-pilot-test-of-digital-currency-11587385339.

4. *See* Issaku Harada, *China aims to launch digital yuan by 2022 Winter Olympics*, NIKKEI ASIAN REV. (May 27, 2020), https://asia.nikkei.com/Spotlight/Cryptocurrencies/China-aims-to-launch-digital-yuan-by-2022-Winter-Olympics.

digital payments in 2018.[5] Hence, Chinese citizens may quickly embrace the DCEP. The GOC is currently pushing for a cash-free economy and the GOC intends the DCEP to replace paper renminbi altogether.[6]

B. *A Primer: What is Cryptocurrency?*

Cryptocurrency is a digital asset operating as a medium of exchange with decentralized control.[7] Prior to the creation of cryptocurrencies with Bitcoin in 2008, digital assets suffered from the double-spending problem, in that there was no way to ensure the same digital asset is or is not spent more than once.[8] The ingenious feature of cryptocurrencies is the lack of a need for a centralized authority to verify transactions. As a computerized consensus protocol, distributed ledgers, such as blockchain, resolve the double-spending problem.[9]

A distributed ledger is essentially a replicating database shared on a peer-to-peer network, hosted by nodes.[10] Nodes are physical computers or servers that maintain a copy of the distributed ledger.[11] Computers access nodes and verify additions to the ledger through consensus methods such as through mining—as in solving proof-of-work or proof-of-stake consensus algorithms.[12] In proof-of-work consensus, the miner or validator validates new additions to a ledger by the amount of energy devoted to solving an algorithm.[13] Alternatively, in proof-of-stake consensus, the miner or validator validates news additions to a ledger based

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5. *See* Rita Liao, *China Roundup: Xi's Power on Bitcoin, the Rise of Alibaba's New Rival*, TECHCRUNCH (Oct. 27, 2019), https://techcrunch.com/2019/10/27/china-roundup-oct-26-2019/ (citing to Zhongguo Renmin Yinhang (中国人民银行) [The People's Bank of China], Zhongguo Puhui Jinrong Zhibiao Fenxi Baogao (2018 Nian) (中国普惠金融指标分析报告(2018年)) [Annual Report on Inclusive Finance in China (2018)] at 3).

6. *See China's PBOC Says Its Own Cryptocurrency is 'Close' to Release*, BLOOMBERG NEWS (Aug. 12, 2019), https://www.bloomberg.com/news/articles/2019-08-12/china-s-pboc-says-its-own-cryptocurrency-is-close-to-release ("Mu [the deputy director of the PBOC's payments department] repeated the PBOC's intention that the digital currency would replace M0, or cash in circulation, rather than M2, which would generate credit and impact monetary policy. The digital currency would also support the yuan's circulation and internationalization, he said.").

7. *See* ANTONY LEWIS, THE BASICS OF BITCOINS AND BLOCKCHAINS: AN INTRODUCTION TO CRYPTOCURRENCIES AND THE TECHNOLOGY THAT POWERS THEM 14, 28 (1st ed. 2018).

8. *See id.* at 184.

9. *See id.*

10. *See id.* at 150–51.

11. *See id.*

12. *See id.*; *see also* Jake Frankenfield, *Proof-of-Stake*, INVESTOPEDIA (Aug.11, 2019), https://www.investopedia.com/terms/p/proof-stake-pos.asp.

13. *See* LEWIS, *supra* note 7, at 166–70.

on how much stake or assets the miner holds according to the ledger.[14] Though often public (permission-less), a distributed ledger may be private (permissioned).[15] Each new addition to the ledger includes a history of previous transactions on the ledger.

C. *What is Stablecoin?*

Stablecoins differ from cryptocurrency in several significant ways. First, stablecoins are pegged to another store of value, such as fiat money, a commodity, a cryptocurrency, or an index.[16] Cryptocurrencies are subject to price volatility.[17] In contrast, stablecoins share volatility and risks with their backing assets.[18] Second, unlike cryptocurrencies, stablecoins are centralized.[19] Stablecoins rely on a central authority to keep the stablecoin pegged to an underlying asset.[20]

Despite alleviating volatility, stablecoins require trust in the centralized authority.[21] A stablecoin can either be backed or collateralized with another asset.[22] Stablecoins can be subject to counter-party risk if the party owning the underlying asset refuses to exchange the asset for the stablecoin or fails to maintain the value of the stablecoin relative to the asset.[23]

A central bank issuer of stablecoins helps eliminate counter-party risk.[24] The central bank, especially if the stablecoin is backed by the currency the central bank issues, can be trusted to exchange the coin with

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14. *See* Frankenfield, *supra* note 12.

15. *See* LEWIS, *supra* note 7, at 328–30.

16. CFTC TECHNOLOGY ADVISORY COMMITTEE SUBCOMMITTEE ON VIRTUAL CURRENCIES, SUMMARY OVERVIEW OF STABLECOINS AND THE LAW REGARDING STABLECOINS (Oct. 3, 2019), https://www.cftc.gov/media/2731/TAC100319_Stablecoins/download [hereinafter TECHNOLOGY ADVISORY COMMITTEE]; *see also* G7 WORKING GROUP ON STABLECOINS, INVESTIGATING THE IMPACT OF GLOBAL STABLECOINS (Oct. 2019), https://www.bis.org/cpmi/publ/d187.pdf.

17. *See* LEWIS, *supra* note 7, at 33–35.

18. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

19. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

20. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

21. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

22. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

23. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16.

24. *See* Hossein Nabilou, *Central Bank Digital Currencies: Preliminary Legal Observations*, J. BANKING REG. (Jan. 2019), https://www.researchgate.net/publication/331244877_Central_Bank_Digital_Currencies_Preliminary_Legal_Observations.

currency.[25] Unlike non-state issued cryptocurrencies, a country-issued stablecoin allows a country to maintain monetary sovereignty by controlling the redeemable rate for the stablecoin into its currency.[26] Since the PBOC issues renminbi and will issue the DCEP, the DCEP will likely be collateralized by the renminbi and exchangeable and redeemable with renminbi.

Nevertheless, owners of stablecoin, unlike cryptocurrencies, must trust a central authority to maintain a ledger if proof-of-work or proof-of-stake algorithms are not applied to verify transactions.[27] A central authority is also entrusted with issuing a reasonable supply of the coin. If a central authority issues too much stablecoin relative to its backing currency or fails to maintain a reasonable exchangeable rate, the value of the coin will become unpredictable.[28]

D. *The DCEP is a Stablecoin*

The DCEP is a central bank digital currency stablecoin, as opposed to a cryptocurrency. It is pegged 1:1 to the Chinese national currency, the renminbi.[29] The PBOC will issue the DCEP, and the GOC will maintain complete control of the creation of the DCEP.[30] Hence, the DCEP is a centralized, sovereign-issued, and sovereign-controlled currency.

The PBOC will initially issue the DCEP to commercial banks affiliated with the GOC.[31] The DCEP will then be distributed to domestic companies that operate major online payment systems in China, such as Tencent with WeChat Pay and Alibaba with AliPay.[32] The GOC has mandated that all Chinese citizens and corporations accept the DCEP.[33]

The GOC has also acknowledged that although banks will maintain users' digital wallets and users will have the option to conduct

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25. *See id.*

26. *See id.*

27. *See* TECHNOLOGY ADVISORY COMMITTEE, *supra* note 16; G7 WORKING GROUP ON STABLECOINS, *supra* note 16, at 6.

28. *See* Fan Yifei, *Some Thoughts on CBDC Operations in China*, CENTRAL BANKING (Apr. 1, 2020), https://www.centralbanking.com/fintech/cbdc/7511376/some-thoughts-on-cbdc-operations-in-china.

29. *See* Paul Muir, *Beijing Warns Against Cryptocurrency Activity*, ASIA TIMES (Dec. 29, 2019), https://asiatimes.com/2019/12/beijing-warns-against-cryptocurrency-activity/.

30. *See* Naomi Xu Elegant, *Why China's Digital Currency is a "Wake-Up Call" for the U.S.*, FORTUNE (Nov. 1, 2019), https://fortune.com/2019/11/01/china-digital-currency-libra-wakeup-call-us/.

31. *See* Goh, *supra* note 2; *see also* Michael, *supra* note 2.

32. *See* Goh, *supra* note 2.

33. Gantori, *supra* note 1, at 3.

transactions quasi-anonymously, the GOC will maintain a record of all the DCEP transactions through a government-managed, private distributed ledger.[34] Given the GOC's stated goals to combat money laundering and drug transactions, the GOC will likely be able to find out who holds a wallet.[35] For example, the GOC could demand that banks disclose the information of wallet holders to the government, or the GOC could work with the banks to obtain this information. The GOC could also link DCEP transactions to IP addresses and locations, and thereby, to individuals. Thus, the GOC may know who owns a digital wallet and the exact amount of digital currency held in each wallet. Additionally, the GOC has stated that the DCEP is designed to replace the Reserve Money (M0) system, meaning that the DCEP may eventually supplant paper renminbi and operate as the only currency in China.[36]

E. *The DCEP Compared to Venezuela's Stablecoin*

The Venezuelan stablecoin, the Petro, demonstrates some of the trade concerns with sovereign-issued stablecoins. The Petro is a planned stablecoin to be issued by Venezuela and backed by barrels of crude oil reserves. Thus, unlike the DCEP, the Petro is not backed by its country's currency even though it can be exchanged for Venezuelan pesos.[37] The Venezuelan Petro is not exchangeable for barrels of oil and thus is not collateralized by or exchangeable for its backing asset.[38] The United States has accused Venezuela of using the Petro to circumvent economic sanctions and to access international financing.

34. *See* Daan de Jonge & Max de Jonge, *China and Digital Currency Electronic Payment (DCEP): Channeling Innovation*, ASIA DIALOGUE (May 9, 2019), https://theasiadialogue.com/2019/05/09/china-and-digital-currency-electronic-payment-dcep-channelling-innovation/.

35. *See* Gantori, *supra* note 1, at 3.

36. *See* Freshfields Bruckhaus Dreinger LLP, *Breaking boundaries, building blockchains – the People's Bank of China*, LEXOCOLOGY (Nov. 12, 2019), https://www.lexology.com/library/detail.aspx?g=850888f6-f154-4008-b301-06fb73a07fca ("The aim is for mobile wallets and digital currency to substitute physical RMB notes and coins—i.e., to replace 'M0.'"); *see generally* Nathaniel Popper et al., *Will Cash Disappear?*, N.Y. TIMES (Nov. 14, 2017), https://www.nytimes.com/interactive/2017/11/14/business/dealbook/cashless-economy.html (discussing the decline of cashe and rise of digital currencies).

37. *See* Aaron Brown, *Venezuela's Failed Cryptocurrency is the Future of Money*, BLOOMBERG (May 10, 2019), https://www.bloomberg.com/news/articles/2019-05-10/venezuela-s-failed-cryptocurrency-is-the-future-of-money.

38. Jack Karsten & Darrell M. West, *Venezuela's "petro" Undermines Other Cryptocurrencies—and International Sanctions*, BROOKINGS INST. (March 9, 2018), https://www.brookings.edu/blog/techtank/2018/03/09/venezuelas-petro-undermines-other-cryptocurrencies-and-international-sanctions/.

Thereby, the United States barred U.S. citizens from dealing in the Petro.[39]

In December 2018, Venezuela filed a complaint against the United States to the World Trade Organization (WTO) that demonstrates one of the trade concerns with stablecoins. Venezuela alleges that the United States imposed "discriminatory coercive trade-restrictive measures with respect to transactions in Venezuelan digital currency."[40] The complaint alleges that the United States is violating the General Agreement on Trade in Services (GATS) by showing less favorable treatment to Venezuelan financial services than domestic financial services:[41]

> The coercive measures of the United States to which Venezuelan financial services and financial service suppliers are subject, under which suppliers receive less favourable treatment than that accorded to like services and service suppliers of WTO Member States not subject to the measures, are in violation of Article II:1 of the GATS. Furthermore, inasmuch as digital currencies originating in the United States are not subject to the same prohibitions as Venezuelan digital currencies, the United States accords less favourable treatment to Venezuelan financial services and service suppliers than to like domestic financial services and service suppliers, in violation of Article XVII:1 of the GATS.

The DCEP could face a similar dilemma to the Petro; the GOC could use the DCEP to circumvent possible sanctions and face international discrimination. For example, China may face future sanctions concerning its conduct in relation to Hong Kong's and Taiwan's possible continued separation from China. The GOC could use the DCEP to evade sanctions as well as to extend credit to sanctioned governments such as North Korea, Russia, and Iran. As argued in Venezuela's complaint, countries may risk violating Article XVII:1 of the GATS by refusing to deal in a country's digital currency while accepting domestic digital currencies. Thereby, in order to avoid violating the GATS and to continue trading with China, WTO members will likely have to embrace the DCEP as China's new currency.

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39. Exec. Order No. 13,827, 83 Fed. Reg. 12,469 (Mar. 19, 2018).

40. *See* Request for Consultations by Venezuela, *United States—Measures Relating to Trade in Goods and Services*, WTO Doc. WT/DS574/1 (Jan. 8, 2019).

41. *See id.* ¶ 4, at xi.

II. China's Motives: Why Does China Want to use Digital Currency?

In its Thirteenth Five-Year Plan (FYP) begun in 2016, China stated that it hopes to "expand exports, increase outbound and inbound investment, promote international use of [and support of trade in] the RMB, and enhance China's role in global economic governance."[42] Co-existing with the "One Belt, One Road Initiative" (Belt and Road Initiative), which the U.S. Department of Commerce sees as an important contributor to this goal,[43] the DCEP is arguably just as important of a contributor to China's economic and global trade ambitions.

The DCEP will mainly facilitate two goals of which the GOC has held for the past two decades. First, the DCEP will accelerate the internationalization of the renminbi. Second, the DCEP will augment government oversight of the financial sector, the renminbi, and Chinese citizens while creating an appearance of increased marketization and liberalization. Traditionally, internationalization hinders government oversight. However, with digital currency, the GOC can accomplish both goals concurrently while insulating the renminbi from instability. By increasing government oversight and internationalization of the renminbi, the DCEP can potentially impact China's WTO status and its role in international trade.

A. *Goal One: The DCEP Facilitates Internationalization of Chinese Currency*

The DCEP will broaden access to Chinese currency. The Chinese government has taken strides to catalyze the internationalization of its currency and pushed for the adoption of the renminbi to supplant the U.S. dollar as the world's principal foreign reserve currency.[44] Though the renminbi is one of five currencies listed as a global reserve currency and included in the International Monetary Fund's (IMF) Special Drawing Rights Basket, its internationalization has stalled since 2016.[45] Though China will initially release the DCEP to domestic banks and

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42. *See* Katherine Koleski, U.S.—China Econ. & Sec. Review Comm'n, *The 13th Five-Year Plan* (Feb. 14, 2017), https://www.uscc.gov/sites/default/files/Research/The%2013th%20Five-Year%20Plan_Final_2.14.17_Updated%20(002).pdf.

43. *See id.* at 3, 23.

44. *See* Christopher Brummer, *The Renminbi and Systemic Risk*, 20 J. Int'l Econ. L. 447 (Oct. 13, 2017).

45. *See, e.g.*, Colby Smith, *China's Currency Will Not Replace the U.S. Dollar*, Fin. Times (Sept. 19, 2018), https://ftalphaville.ft.com/2018/09/19/1537329600000/China-s-currency-will-not-replace-the-US-dollar/; *see also* Jacob Pramuk, *IMF Agrees to Include China's RMB in Benchmark SDR Currency Basket*, CNBC (Nov. 30, 2015), https://www.cnbc.com/2015/11/30/imf-agrees-to-include-chinas-rmb-in-benchmark-sdr-currency-basket.html.

favored corporations, the DCEP can increase foreign access to the renminbi without fully subjecting the renminbi to the market forces of supply and demand.

The GOC has implemented numerous measures to increase internationalization, and the GOC is actively trying to increase the appearance of marketization of its economy and currency.[46] To increase cross-border trade RMB settlement, the GOC signed multilateral and bilateral currency swap arrangements with many countries participating in the Belt and Road Initiative.[47] Throughout the 2010s, the GOC has progressively opened up bond markets to foreign investors, and the PBOC has allowed foreign central banks and offshore clearing banks to trade in offshore renminbi bilaterally.[48] In September 2019, China announced the removal of investment quota limitations on its Qualified Foreign Institutional Investor (QFII) program and the Renminbi Qualified Foreign Institutional Investor (RQFII) program.[49] Thereby, the GOC has progressively opened up China's onshore capital market while widening the global liquidity of RMB.[50] The continuation of the opening up of China's onshore capital market to foreign investors is crucial to catalyzing internationalization of the renminbi.[51] The DCEP will likely help spread global liquidity of the renminbi while decreasing risks associated with cross-border transactions and traditional currencies.

46. *See* Brummer, *supra* note 44.

47. *See* Colby Smith, *The Belt and Road's Dollar Problem*, FIN. TIMES (Dec. 18, 2018), https://ftalphaville.ft.com/2018/12/18/1545130791000/The-Belt-and-Road-s-dollar-problem/.

48. *See* Brummer, *supra* note 44, at 468, 469, 473, 476.

49. *See* Hudson Lockett, *China Scraps Purchasing Cap for Approved Foreign Investors*, FIN. TIMES (Sept. 10, 2019), https://www.ft.com/content/c657fb6e-d3b8-11e9-a0bd-ab8ec6435630 ("The State Administration of Foreign Exchange said on Tuesday evening that it had decided to scrap the overall ceiling of $300 bn on total asset purchases under its qualified foreign institutional investor, or QFII, scheme. . . . A renminbi-denominated cap applied to a parallel 'RQFII' programme, initiated in 2011, was also scrapped on Tuesday.").

50. *See* Brummer, *supra* note 44, at 467–83.

51. *See id.* at 472–76 ("Robust capital account liberalization by definition requires not just easing, as described in the preceding section, onshore access to renminbi financial markets for foreign stakeholders. It also entails allowing greater usage of the currency beyond China's borders. China has sought to operationalize this second objective via offshore financial markets and infrastructure designed to enable RMB-denominated investments and payment services.").

Instead of relying on its newly implemented Cross-Border Interbank Payment System (CIPS) to settle cross-border transactions,[52] the GOC could use a distributed ledger for capital settlement and clearing of the DCEP and to distinguish between onshore and offshore transactions and investment. Digital currencies diminish existing payment frictions such as lengthy cross-border transaction times and eliminate the need for an intermediary to settle a transaction.[53] Instead of a traditional payment model in which the payment is authorized by an owner and then taken from the account by the recipient through an intermediary such as a credit card company or clearinghouse, the owner of digital currency directly transfers digital currency to a recipient—"a 'push' model, rather than an 'authorize and pull' model."[54]

With digital currency, a citizen of any country with access to a cellphone or computer and a digital wallet can—absent anticipated regulations—effortlessly transfer his or her country's currency into the renminbi-backed DCEP. The DCEP will allow China to increase the appearance that its currency is marketized for more international adoption while still being able to control the flow of money in and out of its economy.

B. *Goal Two: The DCEP Augments Government Oversight*

Over the past decade, the GOC has found various means to increase government oversight over the economy and its citizens' lives. In 2014, the GOC began to implement a national social credit rating system in which citizens and corporations are numerically rated on their ability to be upstanding.[55] In 2018, the PBOC became the supervisor of the social credit system.[56] Like a credit score, if a Chinese citizen defaults

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52. *See* Kazuhiro Kida, Masayuki Kubota, & Yusho Cho, *Rise of the Yuan: China-Based Payment Settlements Jump 80%*, NIKKEI ASIAN REV. (May 20, 2019), https://asia.nikkei.com/Business/Markets/Rise-of-the-yuan-China-based-payment-settlements-jump-80.

53. *See* Sean Williams, *Ranking the Average Transaction Speeds of the 15 Largest Cryptocurrencies*, MOTLEY FOOL (May 23, 2018), https://www.fool.com/investing/2018/05/23/ranking-the-average-transaction-speeds-of-the-15-l.aspx.

54. Frances Coppola, *Cryptocurrencies Global Payment Solutions*, AM. EXPRESS (2020), https://www.americanexpress.com/us/foreign-exchange/articles/cryptocurrencies-global-payment-solutions/.

55. *See* Mirjam Meissner, *China's Social Credit System*, MERICS (May 24, 2017), https://merics.org/sites/default/files/2020-05/Chinas%20gesellschaftliches%20Bonit%C3%A4tssystem.pdf.

56. Yuhao Zhong & Xiaodong Ding, *Rethinking the Social Credit System: A Long Road to Establishing Trust in Chinese Society*, *in* THE 2ND SYMPOSIUM ON APPLICATIONS OF CONTEXTUAL INTEGRITY 28 (2019), https://privaci.info/symposium2/2nd_CI_Symposium_Report.pdf.

on loans or carries large amounts of debt, his or her social credit score will decrease.[57]

A drawback with paper fiat currency is the difficulty in tracing who spent the paper currency and for what. Payment intermediaries pose a similar problem for the GOC. By utilizing distributed ledger technology, the GOC can possess a record of every transaction of the DCEP.[58] This ability will allow the GOC to monitor its citizens and companies to a historically unprecedented degree.

Furthermore, if the DCEP becomes the sole Chinese currency, the record of DCEP transactions will allow the GOC to track every financial transaction involving individuals and businesses in Chinese currency. In addition to being able to limit money laundering and money for criminal enterprises in Chinese currency, the government can use a distributed ledger or digital token-based record to ensure individuals and businesses report income correctly for taxes and comply with regulations when receiving and extending loans or exchanging currency.

III. International Trade and The DCEP

The unprecedented level of control and oversight afforded by the DCEP may allow the GOC to covertly implement protectionist policies that contravene the WTO's General Agreement on Tariffs and Trade (GATT) and the GATS. Though the use of a distributed ledger allows for more financial transparency, this transparency only extends to entities with access to the ledger. The GOC is slated to be the only entity

57. *See* Charlie Campbell, *How China Is Using "Social Credit Scores" to Reward and Punish Its Citizens*, TIME MAG., https://time.com/collection/davos-2019/5502592/china-social-credit-score/; *see also* Tom McGregor, *China's Social Credit System*, YALE GLOBAL ONLINE: CHANNEL NEWS ASIA (Mar. 6, 2019), https://yaleglobal.yale.edu/content/chinas-social-credit-system-channel-newsasia ("China's social credit system operates on a points system. If you are a law-abiding citizen who pays your dues in a timely manner, the government rewards you with welfare benefits, low interest rates on loans and more. But criminals, delinquents, and those who are default on debts, as well as those indicted for bad behavior when traveling overseas will have lower social credit rankings and be marked as having a 'delisted' status"); *see also* Nadra Little, *Spend "Friviously" And Be Penalized Under China's New Social Credit System*, VOX (Nov. 2, 2018), https://www.vox.com/the-goods/2018/11/2/18057450/china-social-credit-score-spend-frivolously-video-games ("In 2020, China will fully roll out its controversial social credit score. Under the system, both financial behaviors like 'frivolous spending' and bad behaviors like lighting up in smoke-free zones can result in stiff consequences.").

58. *See* BLOOMBERG NEWS, s*upra* note 6, ("According to patents registered by the central bank, consumers and businesses would download a mobile wallet and swap their yuan for the digital money, which they could use to make and receive payments. Crucially, the PBOC could also track every time money changes hands.").

with access to the DCEP ledger.[59] Hence, the GOC could rely on the restricted nature of the DCEP's private ledger to camouflage illegal actions under WTO law.

With state-backed digital currency, the GOC will have greater authority to control exchange rates, allocate domestic and foreign investment, and dictate market entry and exit. In facilitating internationalization of the renminbi and an increase of government control over the economy with the DCEP, China may violate international trade laws. The DCEP will extend the GOC's control over China's economy while allowing the GOC to maintain an illusion of increasing marketization, liberalization, and loosening of state-control.

A. *Anti-Dumping and NME Status*

1. Anti-Dumping Defined

An anti-dumping duty is a protectionist tariff allowed under the WTO, which a member country may implement to protect against imports unfairly priced below fair market value (price-dumped imports) that threaten or cause "material injury" to a competing domestic industry.[60] The United States has placed hundreds of anti-dumping duties on Chinese goods, such as an anti-dumping duty on Chinese steel in 2019.[61] Since the introduction of the DCEP may make the Chinese economy appear more free market-orientated, the GOC may use the unique features of the DCEP to facilitate a petition for non-market economy (NME) status under WTO law. Attaining NME status would lower the rates of anti-dumping duties imposed on China by other WTO member countries.

59. *See* Michael, *supra* note 2 ("DCEP is a digital currency that is run on a centralized private network – the Central Bank of China has complete access and control of the currency"); *see also* Roger Huang, *China's Digital Currency is Unlikely to be a Cryptocurrency*, FORBES (Aug. 14, 2019), https://www.forbes.com/sites/rogerhuang/2019/08/14/chinas-digital-currency-is-unlikely-to-be-a-cryptocurrency/#3c71136d6a52 ("The PBOC will likely design all wallets and will have access to all data on the transactions. It's unclear here if private partners can get involved in terms of analyzing the data or assembling the wallets. Patents filed by the PBOC indicate they want to take end-to-end control of the process, making it unlikely (especially since it'll be regarded as a central bank currency) that there will be many services given permission to access the data generated here or that there may be public records akin to a blockchain.").

60. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, art. VI, para. 1–2:1, :2 [hereinafter GATT 1994].

61. *See* Search Query for "International Trade (Anti-Dumping)", FED. REG., https://www.federalregister.gov/international-trade-anti-dumping-; *see also* Eric Beech & David Lawder, *U.S. Imposes Duties on Structural Steel from China, Mexico*, REUTERS (Sept. 4, 2019), https://www.reuters.com/article/us-usa-trade-steel/us-imposes-duties-on-structural-steel-from-china-mexico-idUSKCN1VP2R7.

2. Why China No Longer Wants NME Status

The DCEP could affect China's status as an NME. Only eleven countries in the world are currently designated as NMEs by the U.S. Department of Commerce.[62] According to the United States and the European Union, China is an NME, and both entities continue to place high "anti-dumping" duties on Chinese goods.[63] In October 2017, the U.S. Department of Commerce summarized China's status as an NME:[64]

> The Chinese government and the CCP's legal and actual ownership and control over key economic actors and institutions pervades China's economy, including the largest financial institutions and leading enterprises in manufacturing, energy, and infrastructure. China's authorities use this control selectively to affect the interaction of supply and demand and accordingly distort the incentives of market actors. This ability to affect these market forces is apparent in crucial facets of the economy, from the formation of exchange rates and input prices to the movement of labor, the use of land, the allocation of domestic and foreign investment, and market entry and exit. Because of the significant distortions arising from China's institutional structure and the control the government and the CCP exercise through that structure, the Department finds that China remains a NME country for purposes of the U.S. antidumping law.

The GOC maintains substantial control over China's economy. Upon entering the WTO in 2001, China, given its command-economy, allowed other WTO members to apply a surrogate country methodology for analyzing prices and costs on products subject to anti-dumping measures.[65] WTO members referenced third-world prices and costs for

62. *See* Daniel Griswold, *Is China a Non-Market Economy?*, MERCATUS (Apr. 2, 2019), https://www.mercatus.org/bridge/commentary/china-non-market-economy.

63. *See* Application of Countervailing Duty Provisions to Nonmarket Economy Countries, Pub. L. No. 112-99, 126 Stat. 265 (2012) (codified as amended at 19 U.S.C. §§ 1671, 1677f-1); *China's Status as a Nonmarket Economy (NME)*, CONG. RES. SERV. 1 (Jan. 10, 2019), https://fas.org/sgp/crs/row/IF10385.pdf [hereinafter *China's Status as a Nonmarket Economy*].

64. Memorandum from Office of Policy, Enforcement & Compliance to Gary Taverman, Deputy Assistant Secretary, on China's Status as a Non-Market Economy, U.S. Dep't of Com. (Oct. 26, 2017), https://enforcement.trade.gov/download/prc-nme-status/prc-nme-review-final-103017.pdf [hereinafter Memorandum].

65. *See China's Status as a Nonmarket Economy*, *supra* note 63.

determining dumping margins as opposed to Chinese domestic prices and costs.[66] China regularly exports products below fair market value and below a price it normally charges in its domestic market.[67] Third-world prices are typically higher than Chinese domestic prices and costs. Hence, the anti-dumping duties imposed on Chinese exports by the EU and the United States routinely exceed the duties that would be levied on a market economy's exports.

In order to lower the amount of antidumping duties imposed on Chinese exported goods, China has argued for market economy status.[68] China also has reached free trade agreements with many countries requiring them to view China as a market economy (ME).[69] In June 2019, China withdrew a WTO dispute settlement claim filed against the EU regarding its failure to treat China as a ME, with reports claiming China was to lose the petition given the GOC's excessive control over its economy, such as its output and price controls.[70]

By applying an NME designation to China, the United States and the EU continue to reference a surrogate country to construct a Chinese product's "normal value" in an anti-dumping investigation.[71] By relying on a surrogate country or countries, as opposed to the producing/exporting country for anti-dumping duties, the EU and the United States can impose higher anti-dumping rates on China than would occur if China's prices and costs were used for the calculation.[72] The practice for designating NMEs exists because market forces of supply and demand do not exist or do not wholly influence prices and costs for goods in an NME country.

66. For the U.S. method of determining dumping margins, see *id.*; for the EU method, *see* Laura Puccio, *Granting Market Economy Status to China, an Analysis of WTO Law and Selected WTO Members' Policy*, EURO. PARLIAMENTARY RES. SERV. (Nov. 2015), at 17 n.69, https://www.europarl.europa.eu/RegData/etudes/IDAN/2015/571325/EPRS_IDA(2015)571325_EN.pdf.

67. *See* Memorandum, *supra* note 64.

68. *See* Jefferey M. Telep & Richard C. Lutz, *China's Long Road to Market Economy Status*, 49 GEO. J. INT'L L. 693 (2018).

69. *See* Puccio, *supra* note 66, at 1.

70. *See* Tom Miles, *China Pulls WTO Suit over Claim to be a Market Economy*, REUTERS (June 17, 2019), https://www.reuters.com/article/us-usa-china-wto-eu/china-pulls-wto-suit-over-claim-to-be-a-market-economy-idUSKCN1TI10A.

71. *See China's Status as a Nonmarket Economy*, *supra* note 63; Puccio, *supra* note 66.

72. *See generally*, *China's Status as a Nonmarket Economy*, *supra* note 63; Puccio, *supra* note 66.

3. How the DCEP Affects the NME Status of China

Depending on how the GOC implements the DCEP, the DCEP will allow China to either distance itself from NME status or reinforce its NME designation. Given that China is currently pursuing full currency convertibility and promoting the use of the renminbi as an international trade reserve currency,[73] China will likely use the DCEP to increase the renminbi's convertibility into other currencies and to distance itself from NME status.

The U.S. Department of Commerce weighs six major factors when presented with a country's formal request for market economy status (MES):

> (1) the extent to which the currency of the foreign country is convertible into the currency of other countries; (2) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (3) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country; (4) the extent of government ownership or control of the means of production; (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and (6) such other factors as the administering authority considers appropriate.[74]

a. Factor One

The DCEP allows China to control the extent to which the renminbi is convertible into the currency of other countries. Due to its digital nature, stablecoin can easily be converted to foreign currencies with lower transaction costs and quicker clearing-times than conversions involving traditional money orders and paper currency.

China, however, may elect to limit the convertibility of the DCEP. China currently has split control over its currency; China currently differentiates between offshore and onshore renminbi.[75] Offshore yuan is

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73. *See* John W. Labuszewski & Sandra Ro, *Offshore Chinese Renminbi Market*, CME GROUP 1 (Mar. 4, 2014), https://www.cmegroup.com/education/files/offshore-chinese-renminbi-market.pdf.

74. *Evaluation of China's Nonmarket Economy Status*, U.S.—CHINA ECON. & SEC. REV. COMM'N (Apr. 18, 2017), https://www.uscc.gov/sites/default/files/Research/Non%20Market%20Economy%20Issue%20Brief.pdf.

75. *See* Brummer, *supra* note 44, at 482 ("Although the renminbi is considered one currency, it at least historically has functioned more similar to two currencies that trade at different rates.

subject to marketization, but currency speculators can short the currency which devalues the price of yuan in general.[76] Thus, China strictly controls the amount of currency available as offshore yuan.[77] Nevertheless, once offshore yuan is held by an individual, the holder can exchange the renminbi for foreign currency at a foreign exchange without China being able to intervene.

China may use the DCEP to begin converging offshore and onshore yuan. For example, China could further marketize offshore yuan while maintaining some control of the currency by monitoring all transactions. On the other hand, China could continue its current trend and negotiate bilateral currency swap agreements with other countries for exchange and trade but denominate these agreements in the DCEP instead of in renminbi. Regardless, China will likely use the DCEP to at least create the appearance that its currency is more convertible and to separate the renminbi from the U.S. dollar as a strong international trade reserve currency.

b. Factors Four and Five

Additionally, the DCEP may allow the GOC to create the appearance that it is becoming a ME in regards to factors four and five (the extent of government ownership or control of the means of production and the extent of government control over the allocation of resources and over the price and output decisions of enterprises). In reviewing the NME status of China in October 2017, the U.S. Department of Commerce concluded that, "China was still an NME because the state's role in the economy and its relationship with markets and the private sector results in fundamental distortions in the Chinese economy."[78] With the tracking of transactions available to the GOC with the DCEP, China can announce marketization of certain industries while maintaining the equivalent of state-owned control behind the scenes by monitoring, blocking, and engaging in transactions of the DCEP with corporations.

c. Factor Three

In its thirteenth FYP, the GOC promised to loosen "foreign investment restrictions in select sectors such as elder care, banking, and

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There has on the one hand been the onshore yuan (traded under the symbol 'CNY'), and on the other the offshore renminbi (alternatively, under the designation 'CNH') based in Hong Kong. Between the two, a difference in value has arisen, due in part to varying yields and capital account restrictions. For many years, their separation has meant that different market equilibriums have impacted their price.").

76. *See id.* at 482–83.

77. *See id.* at 483.

78. *See China's Status as a Nonmarket Economy*, *supra* note 63, at 2.

finance, and encourage imports of advanced technology and equipment and high-quality consumer products . . . [and that China will pursue] . . . "bilateral and multilateral free trade agreements."[79] The loosening of foreign investment restrictions and the advancement of the Belt and Road Initiative[80] will allow China to argue against NME status in regard to factor three as the initiative allows China to increase *the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country*. If the GOC forces businesses in China to use the DCEP, this requirement could help the GOC monitor foreign companies conducting business in China. Thus, the DCEP may incentivize China to further loosen many of the rules surrounding its joint-venture requirement for foreign corporations doing business in China while adding a requirement to use the DCEP.[81] Hence, these events would create the appearance that China is permitting more foreign firms to conduct business in China independent of government oversight while still allowing the GOC to monitor foreign corporations operating in China.

B. *Countervailing Duties and Subsidies*

1. Countervailing Duties and the DCEP

With the DCEP, China may contravene the free trade intentions of the WTO by designing concealed mechanisms to benefit domestic industry while prejudicing foreign competitors. Showing that an actionable subsidy exists allows a petitioning country to remedy an unfair trade practice with a countervailing duty. A countervailing duty is a trade import duty that neutralizes the injurious effects of subsidies.[82] If actionable subsidies are concealed, as possible with the DCEP, a petitioning country may not have enough evidence to restore a fair trade balance. Hence, the DCEP will provide China with a potential route to unfairly bolster its trade position that the WTO may be unprepared to handle.

79. *See* Koleski, *supra* note 42, at 3, 22.

80. *See id.* at 3.

81. For a discussion of the gradual loosening of joint venture requirements, see generally Chris Wright, *China Joint Venture Timetable is Still on Track*, EUROMONEY (Apr. 18, 2017), https://www.euromoney.com/article/b1hp89x8j0f6wz/china-joint-venture-timetable-is-still-on-track.

82. Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14, art. 10, 11.2 (i)–(iv) [hereinafter SCM Agreement].

2. Actionable Subsidies Defined

The WTO defines subsidies into one of two categories: prohibited subsidies and actionable subsidies.[83] Prohibited subsidies are "subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods."[84] The WTO and the United States prohibit these subsidies because the subsidies are "specifically designed to distort international trade and are therefore likely to hurt other countries' trade."[85] Actionable subsidies require the complaining country to show that the subsidy has an adverse effect on its interests.[86] Actionable subsidies can "hurt a domestic industry in an importing country . . ., can hurt rival exporters from another country when the two compete in third markets . . ., [or] hurt exporters trying to compete in the subsidizing country's domestic market."[87]

Adverse interest can be demonstrated by showing: "material injury to a domestic industry caused by subsidized imports in the territory of the complaining member"; "serious prejudice"; or "nullification or impairment of benefits."[88] Also, under the Agreement on Subsidies and Countervailing Measures (SCM Agreement), subsidies must meet a "specificity requirement."[89] Subsidies meet the requirement when they apply to a specific "enterprise or industry or group of enterprises or industries" or region.[90]

To petition for a countervailing duty on a domestic actionable subsidy, a country must show a *financial contribution* exists, *specificity* applies, and there is a *material benefit to the recipient* from the contribution.[91] Financial contribution means: (i) the direct transfer of funds, such as grants, loans, and equity infusions, or the potential direct transfer of funds or liabilities, such as loan guarantees, (ii) foregoing or not collecting revenue that is otherwise due, such as granting tax credits or deductions from taxable income, (iii) providing goods or services, other than general infrastructure, or (iv) purchasing goods.[92]

83. *Id.* art. 3–7.

84. *See Understanding the WTO: The Agreements*, WTO, https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm.

85. *See id.*

86. SCM Agreement, *supra* note 82, art. 5, art. 7.8, 7.9.

87. *Understanding the WTO: The Agreements*, *supra* note 84.

88. *Agreement on Subsidies and Countervailing Measures Overview*, WTO, https://www.wto.org/english/tratop_e/scm_e/subs_e.htm.

89. SCM Agreement, *supra* note 82, art. 2.2.

90. *Agreement on Subsidies and Countervailing Measures Overview, supra* note 88.

91. The Trade Act, 19 U.S.C. §1677(5).

92. SCM Agreement, *supra* note 82, art. 1.1(a)(1)(i–iv); The Trade Act, 19 U.S.C. §1677(5).

3. The DCEP and Actionable Subsidies

China wants to increase the appearance of marketization in its economy, yet China is devoted to subsidizing domestic industries. With the DCEP, China can increase the appearance of marketization in the Chinese economy while covertly extending actionable subsidies to Chinese industries and companies through DCEP transactions. This type of transaction amounts to state-sponsored money laundering and may become increasingly prevalent as central banks issue digital currencies.

China currently subsidizes its domestic market through clandestine mechanisms such as direct transfers of funds, tax rebates, and forgoing the collection of revenue.[93] In addition to outright, unreported transfers of funds, China subsidizes its exports by "strategically raising or lowering the value-added tax (VAT) rebate available upon export."[94] China also utilizes "extensive and varied market access prohibitions and limitations designed to protect" domestic industries.[95] The DCEP will make controlling VAT rebates and market entry and exit even easier for China.

The ability for the GOC to use the DCEP to subsidize industries easily and secretly is increasingly relevant as the GOC launches its Belt and Road Initiative; the GOC may engage in actionable subsidies in foreign countries with the DCEP as the GOC may seek to harm rival exporters in a third country when two countries compete.

4. Specificity Complications

With DCEP, China could report subsidies for some industries while concealing subsidies for other specific industries. In the thirteenth FYP, the Chinese government committed to "redoubling its state-directed strategy . . . to boost market demand for Chinese products and firms through government procurement and customer incentives."[96] In May 2015, China announced the *Made in China 2025* plan in which China is strategically investing in and assisting ten strategic sectors to

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93. U.S. TRADE REP., 2018 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE at 16, 25, 35, 73 (2019), https://ustr.gov/sites/default/files/2018-USTR-Report-to-Congress-on-China%27s-WTO-Compliance.pdf., stating, "As in prior years, in 2018, the Chinese government attempted to manage the export of many primary, intermediate and downstream products by raising or lowering the VAT rebate available upon export. China sometimes reinforces its objectives by imposing or retracting export duties. . . . These practices, together with other policies, such as excessive government subsidization, also have contributed to severe excess capacity in these same industries."

94. *Id.* at 16.

95. *Id.*

96. *Section 3: The 13th Five-Year Plan*, U.S.—CHINA ECON. AND SEC. REV. COMM'N, at 139, https://www.uscc.gov/sites/default/files/Annual_Report/Chapters/Chapter%201,%20Section%203%20-%2013th%20Five-Year%20Plan.pdf.

help corporations in these sectors grow to the detriment of foreign corporations.[97] The "boosting" of market demand for Chinese products and firms will likely involve the GOC using prohibited subsidies and actionable subsidies and concealing them through quasi-anonymous DCEP transactions. As the *Made in China 2025* plan demonstrates, subsidies in China often target specific industries, thereby meeting the *specificity* requirement of countervailing duty law.

5. Financial Contribution Complications

The GOC has stated that individuals and corporations can engage in quasi-anonymous transactions with one another through the DCEP, but the GOC will always know the identities of the parties.[98] Without a public record of transactions, it would be difficult for complaining countries and the WTO to uncover subsidies and enforce countervailing duties as it would be nearly impossible to show the GOC made or directed a financial contribution.

China can offer financial information on an industry while still complicating investigators' abilities to identify a government-linked financial contribution. To dispute a countervailing duty claim arising from another country, China may offer extensive financial statements of corporations through information collected using DCEP token data or from the DCEP distributed ledger. Nevertheless, even if this financial information includes domestic subsidies, it would be difficult for regulators to prove which transactions came from the GOC as only the GOC and banks will know who owns digital wallets and the identifiers of DCEP wallets. In order to easily conceal subsidies and the source of financial contributions, the GOC can itself use or direct banks or shell companies to use numerous anonymous identifiers to financially subsidize industries and spread out transactions to increase the difficulty of identifying the source of subsidies or whether transactions are even part of a subsidy.

6. Examples of How the DCEP May Conceal Actionable Subsidies

Subsidies are pervasive at all levels of government in China—national, regional, and local, and the existence of these subsidies has been an ongoing point of contention between the United States and

97. *Id.* at 150–51.

98. *See* Daniel Phillips, *DCEP: The Big Brother of China's Digital Economy*, BEINCRYPTO (Sept. 8, 2019), https://beincrypto.com/dcep-the-big-brother-of-chinas-digital-economy/.

China in trade negotiations.[99] There are numerous means as to how the GOC can use the DCEP to conceal actionable subsidies. The GOC could prejudicially limit companies from engaging in transactions with the DCEP by discriminately blocking certain transactions, delaying transactions, or controlling access to digital wallets. The GOC could also use the DCEP to buy excess inventory or bad loans from companies and banks while disguising these transactions as legitimate transfers of capital.

These hypothetical subsidies will likely meet the specificity requirement. China maintains majority ownership over domestic banks in China, and the GOC can extend inordinate amounts of the DCEP to banks in certain regions in order to facilitate local and regional specific subsidies, or the GOC can direct banks to lend to certain regions, thereby targeting producers in specific regions of its territory for subsidization.[100] The GOC could also direct banks in smaller regions of China to funnel the DCEP back to industries as concealed industry-specific actionable subsidies or enterprises as enterprise-specific actionable subsidies.

If China maintains NME status, corporations and industries in China may still petition for a separate anti-dumping rate by demonstrating their separation from government control. With the DCEP, the GOC can exploit its influence over Chinese banks to conceal actionable subsidies directed toward specific industries while fabricating a facade of non-state control.

On the other hand, the GOC could utilize the DCEP to trace subsidies originating from other countries to facilitate WTO complaints for actionable subsidies effected by other nations. Thus, the tracing of DCEP transactions can allow China to increase its trade leverage. If the GOC uses a DCEP distributed ledger for auditing purposes, the GOC may selectively audit companies based on its privileged access to information on DCEP transactions. Hence, prosecution and enforcement around DCEP transactions could become selective and favor domestic companies.

Moreover, the GOC or PBOC may know the exact amount of money held in a digital wallet just as a bank knows the exact amount of money

99. Wendy Wu, *US, EU and Japan Take Aim at China with Proposed WTO Rules Targeting State Subsidies*, S. CHINA MORNING POST (Jan 15. 2020), https://www.scmp.com/news/world/united-states-canada/article/3046108/us-eu-and-japan-target-china-new-global-trade-rules.

100. For a discussion on the prevalence of the GOC's control over banking practices in China, *see* Communication from the United States, *China's Trade-Disruptive Economic Model*, WTO Doc. WT/GC/W/745, ¶ 2.5 (Jul. 11, 2018); for the definition of regional *specificity*, *see* SCM Agreement, *supra* note 82, art. 2.2.

held in a checking or credit account. Thus, the GOC could work with companies to advertise to citizens holding large amounts of the DCEP in their wallets as a means to incentivize spending and buttress domestic companies—it is apparent how this process could amount to discrimination in trade. In addition to allowing the GOC to lend money to domestic industries secretly, the DCEP may also allow the GOC to control how its citizens lend as a means to bolster its economy and its currency.

a. Example: The Social Credit System

Furthermore, the DCEP may intertwine with China's new *Social Credit System* to subsidize domestic industries. China's *Social Credit System* will "monitor, rate, and condition the conduct of all companies in China, including foreign companies, and to ensure that all companies operate in accordance with China's industrial policy objectives."[101] China can use the *Social Credit System* to decide which industries and corporations to subsidize or which to extend favorable loans.

The rating mechanism may, in practice, be discriminatory according to the most-favoured-nation (MFN) treatment and national treatment (NT) principles of the GATT.[102] Under the MFN principle, a country, absent an exception or a free trade agreement, must extend any trade concessions and benefits it makes to one nation to all other WTO member countries.[103] The national treatment obligation "is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production."[104]

Corporations, banks, and the Chinese government will likely use *Social Credit* scores to decide which foreign corporations with whom to conduct business. The amount of DCEP transactions a corporation engages in with a foreign company or exchange for a foreign currency could factor into the *Social Credit System* score. The GOC could reduce citizens' and corporations' scores for transacting in the DCEP with a low-scored corporation or with foreign countries that the GOC disfavors. A high score—which may de facto favor domestic industries—may become a prerequisite for attracting customers, receiving credit, and

101. U.S. TRADE REP., *supra* note 93, at 17.

102. *See* GATT 1994, *supra* note 60, art. I, III; *see also* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, art. II, XVII (1994) [hereinafter GATS].

103. *See* GATT 1994, *supra* note 60, art. II.1.

104. Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, 17, WTO Doc. WT/DS8/AB/R (Oct. 4, 1996).

conducting successful business in China. Thereby, a high *Social Credit* score, with DCEP as the means of tracking buying and selling, could become a means for the GOC to subsidize or otherwise benefit domestic industries. Hence, the DCEP could effectuate a discriminatory mechanism against foreign suppliers and producers as a violation of the NT obligation or against WTO member countries as an MFN violation. If the GOC or the PBOC begins to extend monetary rewards or favorable loans for high social credit ratings, these transactions may also amount to actionable subsidies.

C. *Lending Controls*

The use of the DCEP to regulate domestic lending practices will provide China with immediate economic benefits but will also open the GOC's most likely avenue for concealing actionable subsidies: state-directed refinancing of debt obligations. The DCEP will allow China to strengthen its economy by tracking and refinancing bad debt throughout its economy. Nevertheless, the additional oversight afforded by the DCEP will also allow China to financially engineer its lending industry to provide advantages for domestic borrowers and domestic financial services providers.

Favoritism toward domestic financial institutions may be permissible under the Prudential Carve-Out (PCO) of the GATS.[105] The PCO exempts trade in the financial service sector from general and specific GATS fairness commitments.[106] To qualify for the PCO, practices favoring domestic financial service providers ought to be taken for prudential reasons such as to mitigate systemic financial risk.[107] Because financial instability affects an entire economy, the GATS' Annex on Financial Services "gives governments wide latitude to take prudential

105. GATS, *supra* note 102, at Annex on Financial Services, § 2(a) ("Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.").For an analysis of the prudential carve-out, see John Anwesen, *The Prudential Carve-Out Clause: is Risk the New Corrupt Moral*, 4 PENN. ST. J. & INT'L AFF. 749 (2016).

106. *See* Anwesen, *supra* note 105, at 759.

107. *Id.* at 770 (summarizing Panel Report); *Argentina—Measures Relating to Trade in Goods and Services*, WTO Doc. WT/DS453/R (Sept. 30, 2015) at ¶ 7.932.

measures" and excludes central banks from the GATS.[108] Nevertheless, China's refinancing of non-performing loans with the DCEP through its state-owned banks may amount to actionable subsidies.

1. China's Current Debt/Lending Crisis

China is currently dealing with an unsustainable debt lending crisis mainly stemming from a $587 billion (RMB four trillion) stimulus package in 2008 that inundated local governments and Chinese companies with cheap credit.[109] The cheap credit resulted in unsustainable debt burdens and excessive non-performing loans (NPLs).[110] China's total debt to GDP increased from 151.3 percent in 2007 to 254.6 percent in the first quarter of 2016, equaling $27.2 trillion.[111]

In 2014, the GOC's amendments to the national budget law created a fiscal restructuring plan intended to incorporate off-balance sheet borrowing into the official budget, to reduce the risk of default for municipal governments, and to open more affordable lending sources for municipal governments.[112] In July 2016, the GOC approved a plan allowing banks to swap non-performing loans for equity stakes in indebted firms.[113]

2. The DCEP May Facilitate Actionable Subsidies with Lending Arrangements

The GOC could direct its state-owned banks to use the DCEP to refinance bad loans with the intent to financially benefit domestic corporations and not as a prudential measure to alleviate financial risk. The GOC could direct banks to use the DCEP for non-transparent debt-for-equity swaps or other direct transfers of funds at subsidized rates. Thereby, the GOC could use the DCEP to disguise actionable subsidies

108. *Understanding the WTO: The Agreements*, *supra* note 84 ("The financial services annex gives governments very wide latitude to take prudential measures, such as those for the protection of investors, depositors and insurance policy holders, and to ensure the integrity and stability of the financial system. The annex also excludes from the agreement services provided when a government is exercising its authority over the financial system, for example central banks' services.").

109. *Section 3: The 13th Five-Year Plan*, *supra* note 96.

110. *Id.*

111. *Id.*

112. Tanlei Huang, *Tracking China's Debt-to-Equity Swap Program*, PETERSON INST. FOR INT'L ECON. (June 24, 2019), https://www.piie.com/blogs/china-economic-watch/tracking-chinas-debt-equity-swap-program-great-cry-and-little-wool.

113. *See id.*

such as state-directed debt-for-equity swaps as legitimate transactions between state-owned banks and debt-laden companies.

An actionable subsidy must include a showing that a *financial contribution* exists, *specificity* applies, and there is a *material benefit to the recipient* from the contribution.[114] As mentioned, direct transfers of funds are a type of financial contribution which includes grants, loans, and equity infusions, or the potential direct transfer of funds or liabilities, such as loan guarantees.[115] According to the WTO, debt forgiveness, extension of loan maturity, and debt-to-equity swaps are also direct transfers of funds.[116] When a "debt-to-equity swap is intended to address the deteriorating financial condition of the recipient company, the cancellation of the debt amounts to a direct transfer of funds to the company."[117] A common example of a material benefit being conferred with a loan is when a difference exists between the amount the borrower pays on the loan and the amount the recipient would pay on a comparable, market-obtainable commercial loan.[118]

In order for a financial contribution to be an actionable subsidy, the contribution must be made by or at the direction of a government or any public body within the territory of a WTO Member.[119] Thus, the SCM Agreement "applies not only to measures of national governments but also to measures of sub-national governments and of such public bodies as state-owned companies."[120]

China's five largest commercial banks are majority state-owned and operate large branch networks on a nationwide basis, accounting for nearly half of the total bank assets in China.[121] China also has three state-owned policy banks.[122] Additionally, many municipal commercial banks and credit unions in China operate under local government control.[123] The Law of the People's Republic of China on Commercial Banks states, "commercial banks shall conduct their business of lending

114. *See* SCM Agreement, *supra* note 82, art. 1, 1.1(a)(1)(i)–(iv), 1.1(b), 2, 2.1.

115. *See id.* art. 1.1(a)(1)(i).

116. *See* DOMINIC COPPENS, WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS 41 (1st ed. 2014).

117. Report of the Appellate Body, *Japan—DRAMS (Korea)*, ¶ 252, WTO Doc. WT/DS336/AB/R (adopted Nov. 28, 2007).

118. 19 U.S.C. §1677 (5)(E)(ii).

119. *See* SCM Agreement, *supra* note 82, art. 1, 1.1(a)(1).

120. *Agreement on Subsidies and Countervailing Measures Overview*, *supra* note 88, at "Coverage of the Agreement" ¶ 4.

121. *See* Communication from the United States, *supra* note 100.

122. *See id.*

123. *See id.*

in accordance with the needs of the national economic and social development and under guidance of the industrial policies of the state."[124] The beneficial domestic lending arrangements of Chinese state-owned banks may operate as actionable subsidies without the protection of the PCO if the swaps and refinancing of NPLs meet regional, enterprise, and industry specificity and these actions are not directly related to bulwarking the entire financial services industry in China.[125]

3. The DCEP and Lending Arrangements in Practice

In 2018, the GOC implemented a distributed ledger, the Bay Area Trade Finance Blockchain (BATFB), for cross-border transactions.[126] The BATFB allows the GOC to monitor foreign exchange transactions to and from Guangdong with Hong Kong and Macau.[127] With the DCEP, the GOC can use a distributed ledger for the large-scale monitoring and financing of transactions within its economy and with other countries.

To facilitate the tracking of NPLs, the GOC could limit risky lending practices by requiring banks and foreign trade partners to upload lending contracts to a government-operated distributed ledger. If a lending contract is not on the distributed ledger, then a Chinese court could refuse to honor the contract. Thereby, as the operator of the DCEP distributed ledger, the GOC can track the systemic risk of loans and locate bad debt within its economy. The PBOC can alleviate systemic financial risks under the PCO, and this arrangement would provide the GOC with a unique way of mitigating systemic risk posed by NPLs while remaining fair in regard to international trade law.

The GOC could eventually require contracts registered on its distributed ledger to be self-executing as smart contracts with transactions denominated in the DCEP. Thereby, foreign trade partners would not be able to negotiate out of a lending arrangement unless on China's terms as China would be the operator of the ledger. A smart contract framework for trade would benefit China in spreading global use of the

124. Law of the People's Republic of China on Commercial Banks (promulgated by the Standing Comm. Nat'l People's Cong., May 10, 1995, effective Jul. 1, 1995) art. 34.

125. For an analysis on China's subsidies of state-owned enterprises, see Ting-Wei Chiang, *Chinese State-Owned Enterprises and WTO's Anti-Subsidy Regime*, 49 GEO. J. INT'L L. 845 (2008).

126. *China's Central Bank Blockchain Trade Finance Platform Processes $4.5 Billion*, LEDGER INSIGHTS, Aug. 2019, https://www.ledgerinsights.com/chinas-central-bank-blockchain-trade-finance-2/.

127. *See id.*

DCEP and in capitalizing on its alleged "debt trap" lending arrangements arising from the Belt and Road Initiative.[128]

4. An Example of the DCEP's Benefits: Shadow Banking and P2P Lending in China

Another significant portion of China's bad debt stems from shadow banking. In order to circumnavigate strict lending regulations, the shadow banking industry has become an epidemic in China. Shadow banks are not subject to bank limits on loans or deposit rates and face lower capital and liquidity requirements.[129] Hence, shadow banks lend out riskier loans, thereby infusing substantial risk into the Chinese economy.[130]

In an effort to track shadow banking activity, the GOC created the Total Financing Indicator (TSF) in 2010, which acts as a broad measure of credit and liquidity in the Chinese economy.[131] The TSF includes off-balance-sheet forms of financing such as activity by shadow banks.[132] Nevertheless, given the inherently insulated nature of shadow banking from registered banking, China can only approximate the lending activity of shadow banks. A 2016 IMF report discovered that "off-balance-sheet borrowing (shadow banking) in China grew 48 percent to reach around $6 trillion (RMB 40 trillion) in 2015, equal to 58 percent of China's GDP and 40 percent of bank's [sic] corporate debt."[133]

Peer-to-peer (P2P) lending is a form of shadow banking in which borrowers and lenders directly connect without a banking intermediary.[134] P2P platforms in China loaned $61.5 billion in 2016, whereas P2P platforms in the United States only loaned $1.5 billion in 2016, and U.K.

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128. *See* Dylan Gerstel, *It's a (Debt) Trap! Managing China-IMF Cooperation Across the Belt and Road*, CTR. STRATEGIC AND INT'L STUD. (Oct. 18, 2017), https://www.csis.org/npfp/its-debt-trap-managing-china-imf-cooperation-across-belt-and-road.

129. *How Shadowing Banking Works*, THE ECONOMIST (Feb. 1, 2016), https://www.economist.com/the-economist-explains/2016/02/01/how-shadow-banking-works.

130. *See id.*

131. *See China Jan Total Social Financing Hits Record 4.64 Trillion Yuan*, REUTERS (Feb. 15, 2019), https://www.reuters.com/article/china-economy-social-financing/china-jan-total-social-financing-hits-record-464-trln-yuan-idUSZZN3EIF02; *see also* Zhang Tao, *The Growing Problems with China's Total Social Financing Indicator*, CAIXIN GLOBAL (July 23, 2019), https://www.caixinglobal.com/2019-07-23/opinion-the-growing-problems-with-chinas-total-social-financing-indicator-101442983.html.

132. Tao, *supra* note 131.

133. *Id.*

134. Orange Wang & Chad Bray, *China's P2P Lending Market Could be Decimated This Year Amid Beijing Crackdown*, S. CHINA MORNING POST (Apr. 15, 2019), https://www.scmp.com/economy/china-economy/article/3006170/chinas-p2p-lending-market-could-be-decimated-year-amid.

platforms loaned $1.8 billion in 2016.[135] The GOC delegated authority to regulate the P2P firms to district bureaus which had to submit a database to the Commissions of Economy which reports to the PBOC.[136] However, even with this added oversight, the mechanism has failed. In 2019, after implementing strict registration requirements to decrease the number of domestic P2P platforms from 1,021 to about 100, China announced a moratorium for all P2P platforms to transform into small loan providers by 2022.[137]

Since the GOC can track transactions with the DCEP, the GOC will likely be able to intuit with forensic accounting or machine learning which registered digital wallet holders on its distributed ledger are acting as unregistered P2P platforms. Thereby, the DCEP may help China diligently monitor shadow banking and ensure Chinese financial institutions are appropriately registered and comply with the government's financial regulations and capital controls as allowed under the PCO clause. Nevertheless, China may also use the ledger's tracing of non-banking loans to dictate further which industries and regions ought to or ought not to receive access to capital and subsidies.

With its current pursuit of capital account liberalization, China is gradually granting foreign creditors increased access to the Chinese economy.[138] By mitigating the systemic risks of shadowing banking—a problem that exists in most advanced economies as evinced by the 2008 Global Recession—China can, with the DCEP, transform its financial market into one of the world's most well-regulated markets for foreign creditors, albeit a market with excessive state-control.[139]

PART IV: FUTURE OUTLOOK AND CONCLUSION

A. *Future Outlook*

Given that the People's Bank of China (PBOC) will initially only extend the DCEP to banks, the DCEP will not likely have an immediate

135. Cheng Len & Engen Tham, *In China, P2P Insiders Say Regulatory Shortcomings Have Chocked Industry*, REUTERS (Sept. 5, 2019), https://www.reuters.com/article/us-china-p2p-regulation-analysis/in-china-p2p-insiders-say-regulatory-shortcomings-have-choked-industry-idUSKCN1VR055.

136. *See id.*

137. *China gives P2P Lenders Two Years to Exit Industry*, REUTERS (Nov. 27, 2019), https://www.reuters.com/article/us-china-p2p/china-gives-p2p-lenders-two-years-to-exit-industry-document-idUSKBN1Y2039.

138. *See* Brummer, s*upra* note 44, at 468, 469, 473, 476.

139. For a discussion on risks of shadowing banking in China, see *Shadow Banking and Capital Markets Risks and Opportunities*, GROUP OF THIRTY (Nov. 2016), at 27–32, https://group30.org/images/uploads/publications/ShadowBankingCapitalMarkets_G30.pdf.

effect on currency exchange or trade. Most of the DCEP's effects on trade may occur gradually and surreptitiously. For example, the DCEP will initially only replace renminbi cash and coins in circulation (M0).[140] Current cash and checking deposits (M1) and savings accounts and other near money deposits (M2) will remain in existence.[141] Thus, the GOC cannot manipulate currency in a novel way by issuing or retracting more of the DCEP to and from banks since it must operate within its current financial framework of purchasing and extending M1 reserves. Nevertheless, disintermediation in China's financial markets may ultimately occur; Chinese citizens may eventually own digital wallets held directly by the PBOC rather than banks, and the PBOC may eventually use the DCEP for central bank reserves and deposits.

The GOC is openly implementing the DCEP to advance its political and economic goals. The lack of independence between China's banks and the government will also likely result in Chinese banks exploiting the unique features of the DCEP to advance the GOC's goals in international trade. China already controls its financial industry to an extraordinary degree. The PBOC regulates lending between banks and supervises China's clearing, payment, and settlement systems.[142] The GOC also regulates foreign exchange through the State Administration of Foreign Exchange (SAFE).[143] China's banking system is mostly state-owned and operated including four majority state-owned banks considered the largest in the world.[144] The GOC has a history of exploiting capital account controls in order to gain trade leverage.

140. *See* BLOOMBERG NEWS, *supra* note 6.

141. *See id.*

142. *See Payment, Clearing, and Settlement Systems in China*, COMMITTEE PAYMENTS AND MARKET INFRASTRUCTURES REDBOOK, BANK FOR INT'L SETTLEMENTS (2012) at 33, https://www.bis.org/cpmi/publ/d105_cn.pdf. The *Law on the People's Bank of China* has three articles defining PBC's role as a catalyst, operator and regulator of payment, clearing and settlement systems. At fn. 2, Article 4.9 of the Law on the People's Republic of China states "Maintaining the normal operation of the payment, clearing, and settlement systems"; Article 27 states "The People's Bank of China shall organize or assist in organizing clearing systems among banking institutions, coordinate the efforts of such institutions in matter of clearing and provide services in this regard"; and Article 32 states "The People's Bank of China shall have the right of inspecting the implementation of relevant clearing regulations for banking institutions and other institutions and individuals."

143. *See Major Functions*, ST. ADMIN. FOREIGN EXCH., https://www.safe.gov.cn/en/MajorFunctions/index.html.

144. *See* Eric Reed, *Top Ten Largest Banks in the World in 2019*, THESTREET (Dec. 24, 2019), https://www.thestreet.com/personal-finance/biggest-banks-in-the-world.

Regardless of how China implements the DCEP, central bank-issued digital currency (CBDC) will inarguably alter international trade. Tunisia, the Marshall Islands, Senegal, and Venezuela have already issued or announced formal plans for a CBDC.[145] Many other countries are researching whether or not to implement a CBDC.[146] As more countries adopt CBDC, an exchange system will likely emerge in which countries exchange and trade digital currencies with one another. Some CBDCs may operate as stablecoin pegged to the currencies of other nations such as the U.S. dollar. Bilateral and multilateral trade agreements may be denominated in CBDC which will require trust in the issuer of the digital currency to regulate and operate distributed ledgers honestly. The DCEP may facilitate China's investments through the Belt and Road Initiative as China may eventually permit foreign countries and businesses to hold digital wallets.

In practice, CBDC ought to offer advantages over fiat currency by increasing access to banking and eliminating existing payment frictions. For better or for worse, CBDC allows governments to trace the flow of currency to uncover money laundering schemes. CBDC also allows governments to maintain control over currency to thwart the threat on monetary sovereignty posed by non-centralized digital currencies such as Bitcoin. The rest of the world will learn and adapt from China's successes and failures in implementing the DCEP.

B. *Conclusion*

Even if the DCEP is used to manipulate trade by favoring domestic corporations and by concealing actionable subsidies throughout China's economy, WTO members may be unable to refuse deals in a country's digital currency while allowing transactions in other digital currencies.[147] Nevertheless, the rest of the world ought to take measures to ensure China does not abuse any of the advantages offered by the DCEP.[148] China's foreign trade partners will need to monitor the financial records of Chinese companies and the pricing of Chinese

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145. *See* Chen Ye & Kevin C. Desouza, *The Current Landscape of Central Bank Digital Currencies*, BROOKINGS (Dec. 13, 2019), https://www.brookings.edu/blog/techtank/2019/12/13/the-current-landscape-of-central-bank-digital-currencies/.

146. *See id.*

147. *See* GATS, *supra* note 102, art. XVII:1; *see also* Request for the Establishment of a Panel by Venezuela, *United States—Measures Relating to Trade in Goods and Services*, WTO Doc. WT/DS574/2 (Mar. 15, 2019).

148. For an analysis on possible global stablecoin regulations, see *Addressing the Regulatory, Supervisory, and Oversight Challenges Raised by "Global Stable Coin Arrangements"*, FIN. STABILITY BD. (April 14, 2020), https://www.fsb.org/wp-content/uploads/P140420-1.pdf.

goods to determine whether China is using the DCEP to implement new actionable subsidies. Moreover, in order to uncover any possible direct financial contributions arising from the GOC or from state-owned enterprises, China's foreign trade partners ought to petition China for access to a transparent DCEP ledger operated independently from state-owned banks.

China's foreign trade partners should also request that China work with the IMF and its Financial Sector Assessment Program (FSAP) to ensure China does not abuse the DCEP for state-sponsored money laundering. The FSAP can help ensure that China operates the DCEP in a financially stable manner that mitigates systemic risks to global trade and macroeconomic markets. If the DCEP eventually replaces banking reserves, China should work with the Bank of International Settlements and its Basel Committee to ensure transactions conducted in the DCEP do not interfere with national and global financial stability.

In order to adequately regulate GATT and GATS disputes involving a CBDC and the DCEP, the WTO's dispute settlement body and WTO members will need to increase their expertise in digital currencies and distributed ledgers. Governments may eventually implement multilateral and bilateral trade agreements as algorithmic self-executing smart contracts on a distributed ledger.[149] Intellectual property patents may move to a national or to a globally accessible distributed ledger.[150] With the DCEP, China will be a pioneer in applying distributed ledger technology to international trade. Whether China's application of distributed ledger technology and digital currencies to international trade alleviates or begets risks to international trade hinges on how China chooses to implement the DCEP and how WTO members elect to respond to the DCEP's evolution.

149. For an analysis on distributed ledger technology and smart contracts in international trade, see Emmanuelle Ganne, *Can Blockchain Revolutionize International Trade?*, WTO (2018), https://www.wto.org/english/res_e/booksp_e/blockchainrev18_e.pdf.

150. *See id.* at 57–67.