Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

August 6, 2014

Debates over "Currency Manipulation"

Overview

Some Members of Congress and policy experts argue that U.S. companies and jobs have been adversely affected by the exchange rate policies adopted by China, Japan, and a number of other countries. They allege that these countries use policies to "manipulate" the value of their currency in order to gain an unfair trade advantage against other countries, including the United States.

Other analysts are more skeptical about currency manipulation being a significant problem. They raise questions about whether government policies have long-term effects on exchange rates; whether it is possible to differentiate between "manipulation" and legitimate central bank activities; and the net effect of currency manipulation on the U.S. economy.

Background

What is currency manipulation? At the heart of current debates is whether or not other countries are using policies to intentionally weaken the value of their currency, or sustain a weak currency, to gain a trade advantage. A weak currency makes exports less expensive to foreigners, which can spur exports and job creation in the export sector.

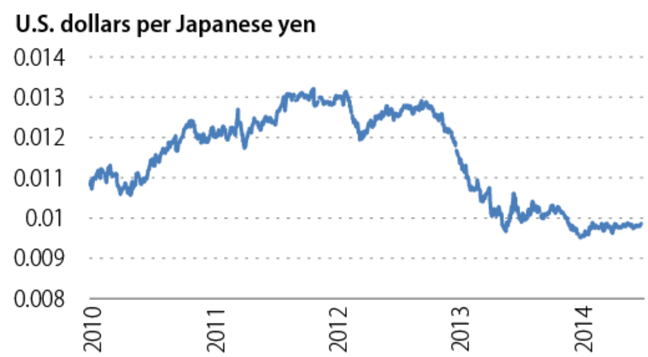
Can governments weaken their currencies? Economists disagree about whether government policies have long-term effects on exchange rates, particularly for countries with floating exchange rates. However, some economists believe that, at least in the short run, some government policies can impact the value of currencies. One policy is buying and selling domestic and foreign currencies ("intervening") in foreign exchange markets. Another is monetary policy, the process by which the central bank controls the supply of money in an economy. It is important to note that although these policies can affect exchange rates, they may be implemented for other reasons, such as increasing foreign exchange reserves or combatting a domestic recession.

What is the impact on the United States? If another country weakens its currency relative to the dollar, U.S. exports to the country may be more expensive and U.S. imports from the country may be less expensive. As a result, U.S. exports to the country may be negatively affected, and U.S. producers of import-sensitive goods may find it hard to compete with imports from the country. On the other hand, U.S. consumers who buy imports and U.S. businesses that rely on inputs from overseas may benefit, because goods from the country may be less expensive.

Which countries are accused of currency manipulation? There is debate over which countries, if any, are manipulating their exchange rates. Part of the debate is which, if any, government policies should count as currency manipulation. Economists have also developed a number of models to estimate whether the actual value of a currency differs from what it "should" be according to economic fundamentals. Various models produce different results.

A 2012 study by the Peterson Institute of International Economics identifies countries that have engaged in large interventions in foreign exchange markets over a long period of time as "currency manipulators." These countries include China, Denmark, Hong Kong, Malaysia, South Korea, Singapore, Switzerland, and Taiwan.

Some analysts have also recently accused Japan of currency manipulation. In the first half of 2013, Japan's central bank launched a new set of expansionary monetary policies, similar to the Fed's quantitative easing programs. Japan's policies contributed to a decline in the value of the yen relative to the U.S. dollar. Japanese officials deny any manipulation of the yen.



Note: A decrease means depreciation of the yen relative to the dollar and an increase means appreciation of the yen relative to the dollar.
Source: Federal Reserve

Existing Policy Frameworks

What frameworks are in place to address currency manipulation? Multilaterally, members of the International Monetary Fund (IMF) have committed to refraining from manipulating their exchange rates to gain an unfair trade advantage. Violators could face loss of IMF funding, suspension of voting rights or, ultimately, expulsion from the IMF. The IMF has never publicly labeled a country as a currency manipulator. Some argue that commitments made in the context of the World Trade Organization (WTO) are relevant to disagreements over exchange rates, although this view is debated. Exchange rates have also been discussed by the G-7 and the G-20.

In the United States, the 1988 Trade Act (P.L. 100-418) addresses currency manipulation. A key component requires the Treasury Department to analyze the exchange rate policies of other countries. If some countries are found to be manipulating their currencies, the Act requires the Treasury Secretary, in some instances, to initiate negotiations to eliminate the "unfair" trade advantage. The Act also has a semiannual reporting requirement on exchange rates in major trading partners. Treasury has not found currency manipulation under the terms of the Act since 1994.

Are current frameworks effective? Some argue that they are ineffective, particularly because the definitions of "manipulation" are too vague. Others argue that the frameworks are effective, and no recent actions have been taken by Treasury or the IMF because no country is manipulating its currency.

> *"We, the G-7 Ministers and Governors, reaffirm our longstanding commitment to market determined exchange rates and to consult closely in regard to actions in foreign exchange markets."*
> Statement by the G-7 Finance Ministers and Central Bank Governors, February 12, 2013.

Congressional Proposals

Some Members are calling for currency manipulation to be addressed in trade agreements. In 2013, 230 Representatives and 60 Senators sent letters to the Obama Administration calling for currency manipulation to be addressed in trade agreements under negotiation, particularly in the Trans-Pacific Partnership (TPP). The TPP is a proposed free trade agreement that the United States is negotiating with Japan and 10 other countries in the Asia-Pacific region.

Additionally, addressing currency manipulation is identified as a principal negotiating objective in Trade Promotion Authority (TPA) legislation introduced in the House and the Senate in January 2014 (H.R. 3830; S. 1900). TPA is the authority Congress grants to the President to enter into certain reciprocal trade agreements and to have their implementing bills considered under expedited legislative procedures when certain conditions have been met.

The January 2014 bills call for U.S. trade agreement partners to "avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain unfair competitive advantage." The language calls for multiple remedies, "as appropriate," including "cooperative mechanisms, enforceable rules, reporting, monitoring, transparency, or other means." When TPA was last renewed in 2002, Congress included exchange rate issues in the "promotion of certain priorities" section (P.L. 107-210).

Additionally, two bills introduced in the 113th Congress are specifically focused on exchange rates:

- The *Currency Reform for Fair Trade Act* (H.R. 1276) would apply U.S. countervailing laws to imports from countries whose currencies were "fundamentally undervalued." This would allow higher import duties on merchandise imports from countries with "fundamentally undervalued" currencies.
- The *Currency Exchange Rate Oversight Reform Act of 2013* (S. 1114**)** would, among other provisions, proscribe negotiations and consultations with countries with fundamentally "misaligned" exchange rates, and specify actions to take against countries that have failed to take action to eliminate exchange rate misalignments.

Possible Policy Issues

How should currency manipulation be defined and measured? Analysts debate the best way to define or operationalize currency manipulation. For example, some argue that the IMF's definition requires it to determine that policies shaping the exchange rate level have been for the express purpose of increasing net exports, and that "intent" is hard to establish. Analysts also disagree on how to calculate or estimate whether currencies are misaligned from their "equilibrium" long-term value, making the classification of currencies as over- or under-valued complex and subject to much debate.

If the United States were to address currency manipulation, what is the best forum for doing so? Different forums for addressing currency manipulation have various pros and cons. For example, some argue that addressing currency manipulation in a trade agreement is a promising alternative to existing frameworks and sensible given the strong links between exchange rates and trade. Others disagree, because any agreement on currencies would apply only to parties of the agreement (and not to countries more broadly in the global economy) and could make the agreement more difficult to conclude.

Would measures to combat currency manipulation serve U.S. economic interests? Some analysts argue that currency manipulation gives other countries an unfair competitive trade advantage over the United States. Others disagree, arguing that the effects on the U.S. economy are not unambiguously negative. U.S. consumers and U.S. businesses that rely on inputs from overseas may benefit when other countries have weak currencies. They also caution that labeling other countries as currency manipulators could trigger retaliation, making it more difficult for the United States to finance its trade deficit.

For more information, see CRS Report R43242 *Current Debates over Exchange Rates: Overview and Issues for Congress* by Rebecca Nelson.

Rebecca M. Nelson, rnelson@crs.loc.gov, 7-6819

IF00045