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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.

Over the past decade, some policymakers and analysts have alleged that China uses policies to keep the value of its currency artificially low, making it harder for U.S. goods to compete in global markets. In recent years, slowing growth in China has put downward pressure on its currency and its central bank has intervened in foreign exchange markets to prevent further depreciation of its currency since mid-2015. The IMF estimates that the value of China's currency is currently in line with economic fundamentals. Some argue that more assertive action on China currency could bolster U.S. competitiveness, while others caution that it does not reflect current Chinese economic policies and risks triggering a trade war with China.

Some policymakers and analysts have also voiced concerns more generally about currency manipulation, particularly as the dollar began to strengthen in recent years (**Figure 1**) and makes it more difficult for U.S. exports to compete overseas and U.S. industries to compete with imports.

Figure 1. U.S. Dollar Index (Major Currencies)

Source: Federal Reserve.

Notes: An increase on the graph represents an appreciation of the U.S. dollar against other currencies.

Existing Policy Frameworks

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 are also discussed by the G-7 and the G-20, where commitments to refrain from currency manipulation are now routinely emphasized.

> "We recognize that excessive volatility or disorderly movements in exchange rates can have adverse implications for economic and financial stability. We will refrain from competitive devaluations, and will not target our exchange rates for competitive purposes."
> *G-20 Finance Ministers and Central Bank Governors Communiqué, March 19-20, 2018.*

Provisions in U.S. law also address currency manipulation. The **1988 Trade Act** (P.L. 100-418) requires the Treasury Department to analyze semiannually the exchange rate policies of major U.S. trading partners. 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.

The **Trade Facilitation and Trade Enforcement Act of 2015** (P.L. 114-125) also directs the Treasury Department in some instances to take action against countries that have: (1) a significant bilateral trade surplus with the United States; (2) a material current account surplus; and (3) engaged in persistent, one-sided interventions in foreign exchange markets. Some economists contend that, together, these three indicators suggest currency manipulation. To date, Treasury has not found a country that meets all three criteria. However, it has developed a new "Monitoring List," which includes major trading partners that meet two of the three criteria currently or in the past year. The Monitoring List for April 2018 includes China, Japan, Germany, South Korea, Switzerland, and India. The legislation also enhances Treasury reporting on exchange rates, and establishes an advisory committee on international exchange rate policy to advise the Treasury Secretary.

In 2015, Congress included currency as a principal negotiating objective in **Trade Promotion Authority** legislation for the first time (P.L. 114-26). 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. Largely in response to the TPA legislation, the United States was a key driver in negotiating an agreement in 2015 to combat currency manipulation among the 12 countries negotiating the Trans Pacific Partnership (TPP), a proposed free trade agreement. The currency side agreement was to become effective if and when the TPP entered into force. President Trump withdrew the United States from the TPP in January 2017. The other 11 TPP countries forged ahead with a trade agreement in March 2018.

Recent Developments

Debates about currency manipulation, including the extent to which other countries are engaged in manipulation and what, if anything, the United States should do to address it, continue.

During the 2016 presidential campaign, combatting currency manipulation, particularly by China, was a key issue for Donald Trump. Since assuming office, President Trump has continued to express concerns about the exchange rate policies of other countries, although the Treasury Department has not formally labeled a country as a currency manipulator.

In the renegotiation of the North American Free Trade Agreement (NAFTA), the Trump Administration has identified combatting currency manipulation as a negotiating objective. In March 2018, the Administration announced that, through negotiating modifications to the U.S.-South Korea Free Trade Agreement (KORUS FTA), the Treasury Department was finalizing a side agreement on currency with South Korea. The details of the agreement are not yet public.

Possible Policy Issues

How should currency manipulation be defined and measured? Analysts debate how to define currency manipulation. 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, complicating the classification of currencies as over- or under-valued.

Should currency manipulation be addressed in trade agreements? Some argue that, given the links between exchange rates and trade, addressing currency manipulation in a trade agreement is critical. Others disagree, since any agreement on currencies would apply only to parties of the agreement 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 M. Nelson.

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