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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 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

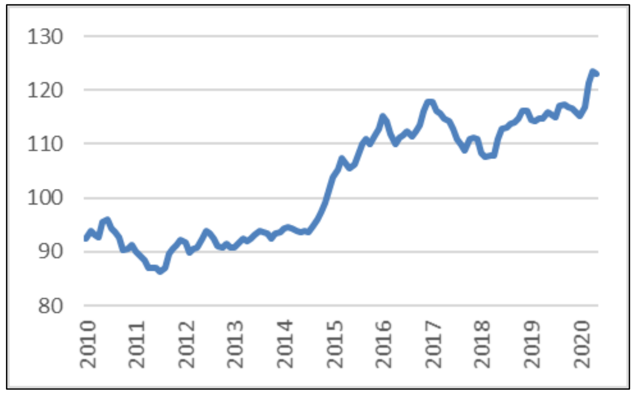
What is currency manipulation? At the heart of current debates is whether or not other countries are using policies to intentionally weaken the value of their currency, or sustain a weak currency, to gain a trade advantage. If another country weakens its currency relative to the dollar, U.S. exports 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.

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 assess that, at least in the short run, some government policies can affect the value of currencies. One policy is buying and selling domestic and foreign currencies ("intervening") in foreign exchange markets. A number of economic policies, including monetary, fiscal, and structural policies, may also affect exchange rate levels but they may be pursued for policy goals unrelated to trade. For example, a central bank may adopt expansionary monetary policies to combat a domestic recession, which may have the simultaneous effect of depreciating the currency.

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.

According to a 2017 study by economists at the Peterson Institute for International Economics, currency manipulation has largely been in remission since 2014. However, the dollar has strengthened in recent months following the outbreak of the COVID-19 pandemic and ensuing economic lockdowns (**Figure 1**), which may renew currency concerns. A strong dollar makes it more difficult for some U.S. firms to compete against foreign producers.

Figure 1. Nominal Broad Dollar Index



Source: Federal Reserve.

Note: An increase on the graph represents an appreciation of the U.S. dollar against other currencies. Monthly data through May 2020.

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

Provisions in U.S. law also address currency manipulation. The **1988 Trade Act** (P.L. 100-418) requires the Treasury Department to analyze and report on 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. Between August 2019 and January 2020, Treasury Secretary Steven Mnuchin labeled China as a currency manipulator under the terms of the 1988 Trade Act, the first such designation in 25 years.

The **Trade Facilitation and Trade Enforcement Act of 2015** (P.L. 114-125) adds new reporting requirements and 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 "Monitoring List," which includes countries that meet two of the three criteria currently or in the past year. The Monitoring List for January 2020 includes China, Germany, Italy, Ireland, Japan, Malaysia, Singapore, South Korea, Switzerland, and Vietnam.

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. Previously, exchange rates were not generally part of trade negotiations.

> "Treasury continues to press other economies to uphold the exchange rate commitments they have made in the G-20, the G-7, and the IMF." *Treasury Department, Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States, January 2020.*

Trump Administration Actions

During the 2016 presidential campaign, Donald Trump raised currency manipulation, particularly by China, as a key issue. Since assuming office, the Trump Administration has taken actions to address concerns about the exchange rate policies of other countries.

- The United States-Mexico-Canada Agreement (USMCA) includes, for the first time in a trade agreement, provisions on exchange rates, widely viewed as a template for future trade negotiations. The USMCA implementing legislation passed the House in December 2019, and the Senate in January 2020 (H.R. 5430). President Trump signed the implemented legislation in January 2020, and the USMCA is to enter into force on July 1, 2020.

- In February 2020, the Commerce Department issued a final rule that paves the way for imposing tariffs on imports from countries destermined by the U.S. government to be undervaluing their currency relative to the U.S. dollar. Various Members of Congress have debated such a policy for years, including in 2013 and 2015, but Congress has refrained from legislating it due to a variety of concerns, including questions about compatibility with U.S. obligations under the World Trade Organization (WTO). In May 2020, the United Steelworkers filed the first antidumping and countervailing duty petitions under the new rule. Their petitions focus on tires from South Korea, Taiwan, Thailand, and Vietnam.

- Treasury's designation of China as a currency manipulator in August 2019 under the 1988 Trade Act was controversial. Most economists assess that China's actions immediately preceding the designation allowed the Chinese currency to move closer to its market value. Treasury did not find that China met the criteria for currency manipulation under the terms specified in the Trade Facilitation and Trade Enforcement Act of 2015. In response to new currency commitments in the Phase One trade deal between China and the United States, the Trump Administration lifted the designation in January 2020. In that deal, China committed to refrain from competitive devaluation and not target its exchange rate for competitive purposes, as well as to publish relevant information related to exchange rates and external balances. Some of these commitments were modeled after the currency provisions in the USMCA. Some analysts have criticized the provisions as largely reiterating G-20 and IMF commitments and requiring data already disclosed by the Chinese government.

- In December 2019, President Trump criticized Brazil and Argentina for "presiding over a massive devaluation of their currencies," and announced that as a result, the U.S. government would convert their steel and aluminum quotas into tariffs. This statement was controversial. Most economists do not believe that the Brazilian and Argentinean governments were purposefully driving down the value of their currencies. The downward trend in exchange rates was likely driven, economists say, by domestic economic challenges, with both countries selling foreign exchange reserves to hasten the depreciation of their currencies. Additionally, some analysts raised concerns that the steel and aluminum tariffs were intended to address national security concerns rather than currency disputes.

Possible Policy Issues

How will governments adapt their currency policies to respond to the COVID-19 pandemic? Some central banks may loosen monetary policy to stimulate their economies to offset the economic effects of the pandemic. Divergences in monetary policy could lead to sharp exchange rate movements. Should countries coordinate their monetary and exchange rate policies in response to COVID-19? In the context of the pandemic, how should currency manipulation be conceptualized and defined?

Would measures to combat currency manipulation serve U.S. economic interests? Weak exchange rates in other countries can have distributional effects within the United States. U.S. consumers and U.S. businesses that rely on inputs from overseas may benefit when other countries have weak currencies. U.S. producers of import-competing products may find it harder to compete, however. An aggressive response to currency manipulation could also trigger retaliation by other countries.

If currency manipulation should be addressed, what is the proper tool or tools? In addition to including provisions in trade agreements and applying countervailing duties, some analysts have called for "countervailing interventions" in foreign exchange markets and/or addressing currency issues more prominently at the IMF or WTO. What are the tradeoffs of the different policy options? Which most effectively address U.S. concerns?

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

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