Currency Protectionism

The greatest trade impediment facing America.

BY GREG MASTEL

With growing intensity since the late 1980s, efforts have been underway in the United States to link international trade agreements to exchange rates. Since changes in exchange rates directly impact the prices of imports and exports just as do import tariffs and export subsidies—both core subjects of trade negotiations—the connection is obvious. It is also clear that many countries pursued policies aimed at undervaluing their currencies—known generally as currency manipulation—in order to discourage imports and encourage exports.

But the seemingly obvious connections were not enough to bring currency manipulation into the core of trade negotiations. The issues remained largely separate for a number of historical and institutional reasons. In the post-war economic world, trade was seen as the core of the General Agreement on Tariffs and Trade, later to become the World Trade Organization, while exchange rate issues were the province of the International Monetary Fund. In the United States, trade negotiations were carried out by the U.S. Trade Representative while exchange rate issues were jealously guarded by the Department of Treasury.

Conceptually, currency manipulation was difficult to define. All major countries took some measures to control exchange rates and the primary fiscal and monetary tools that could impact exchange rates also impacted all economic activity. It was difficult to clearly separate legitimate national economic policies from attempts to "beggar thy neighbor" through currency manipulation. National authori-

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ties were also not anxious to see their policy tools constrained by trade agreements or subject to meaningful second guessing by foreign governments.

U.S. CONGRESS AND CURRENCY MANIPULATION

Despite these reservations, by the 1980s it became difficult to ignore the fact that several mainly Asian countries—most notably Japan—were pursuing weak currency policies in order to boost exports and domestic employment. The rising U.S. trade deficit pushed international trade onto the front political burner in the late 1980s. Much of the attention focused on various import restrictions maintained by Japan and other trading partners, but the 1988 Trade Act also included a provision directing attention to the impact of exchange rates on trade. The most notable aspect of this provision was a direction that the Secretary of Treasury identify countries that were manipulating the value of their currency in order to "prevent effective balance of payments adjustments" while maintaining "a material global current account surpluses" and "significant bilateral surplus with the United States."

This provision could be seen as rather weak tea, as the Secretary was only directed to identify these countries in a report to Congress and negotiate with them directly or through the IMF to end the manipulation. It was what might be called a "name and shame" approach to addressing currency manipulation. The provision was later amended to take out even much of the perceived sting of naming.

When it was drafted, Congress had a number of countries in mind including Japan and Taiwan, but it rapidly became a China-focused provision because China's current account and trade surplus with the world and particularly the United States began to rise and eclipsed those of all other countries, while China maintained a rigid exchange rate peg between the Chinese yuan and the U.S. dollar. The problem became so pronounced that a number of credible outside observers argued that the yuan was significantly undervalued, by 25 to 40 percent, against the dollar.

Surprisingly, the Department of Treasury under successive U.S. presidents was reluctant to name China as a "currency manipulator" though it did agree that Chinese policies clearly amounted to manipulation. Secretaries of the Treasury generally seemed to prefer to engage Beijing diplomatically on exchange rates rather than name China. They argued—perhaps with some merit—that merely naming China would do little to accomplish results.

As is so often the case, however, Congress grew tired of quiet diplomacy and began to propose more direct sanctions. Notably, in 2005, Senators Charles Schumer (D-NY) and Lindsey Graham (R-SC) proposed legislation to initiate negotiations with China to end its currency manipulation under the threat of the U.S. imposing tariffs on all imports from China. Though this approach seemed to enjoy wide support in Congress, it has not become law because there was a strong argument that imposing such tariffs on China would violate U.S. commitments under the World Trade Organization. If passed, such a provisions might well face a presidential veto driven by the economic and diplomatic impact of ignoring the World Trade Organization and imposing across-the-board tariffs.

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Versions of this original Schumer-Graham proposal, however, are still a dominant feature of congressional discussion of this issue probably because, despite the obvious problems, no one has had a better idea.

There has been congressional support for treating currency manipulation as a subsidy and acting to impose duties on injurious imports under U.S. countervailing duty, which aimed to offset foreign subsidies. This approach continues to have considerable appeal to U.S. industries that face stiff competition from China and perhaps other currency manipulators. But it also raises WTO issues, could be applied only on a product-byproduct basis after injury was demonstrated, and would only address the problem of underpriced imports, not the harm to U.S. exports done by currency manipulation.

THE CURRENT DEBATE

In 2014, the economic backdrop and the political situation has changed. Though China has allowed its currency to appreciate to a degree against the dollar, the mounting trade surpluses and foreign exchange reserves (a byproduct of currency manipulation) continue. China seems willing to do little beyond what its domestic politics dictate on exchange rates. Japan too has begun to play a prominent role once again in the discussion as Prime Minister Abe suggested that lowering the value of Japan's yen is the way for Japan to shake off prolonged economic malaise. The movement of the yen seems to have followed this suggestion.

Fred Bergsten and Joseph Gagnon from the Peterson Institute for International Economics released a study in late 2012 suggesting that manipulation of exchange rates by a number of countries had increased the U.S. trade deficit by $200 to $500 billion per year and resulted in a loss of one to five million U.S. jobs—in short, economic impacts large enough make a real difference to the U.S. economy. In addition to the macroeconomic modeling, the authors sought to advance the debate by defining countries that manipulate currency as those that maintain excessive foreign currency assets, have added to those reserves in the last six months, and maintain a substantial current account surplus. The proposed remedies focus on banding together with other countries that are also victims of currency manipulation and taking counter action as well as potentially using U.S. countervailing duty laws or seeking WTO action.

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The Obama Administration has launched a major trade negotiation among many countries of the Pacific Rim aimed at concluding a regional free trade area known as the Trans-Pacific Partnership. To expedite congressional passage of the TPP and other similar agreements, the Administration has also been working with Congress to revive Trade Promotion Authority, which provides for expedited congressional consideration of trade agreements voting by a time certain (no Senate filibuster) without amendment.

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A leading demand from Congress in return for that authority has been meaningful provisions on currency manipulation. But given the complexity of defining manipulation, the lack of a clear template, and likely resistance among trading partners, creating a provision is no easy task. It might be possible to gain consensus within Congress on defining manipulation as a subsidy actionable under U.S. trade law, but that is at most part of the issue.

The Administration has given some hope for a currency provision in the TPP. But since something like one-third of the TPP partners could be accused of currency manipulation (Singapore and Malaysia are often grouped with Japan), including such a provision would take some effort.

Several congressional leaders recently introduced a version of TPA legislation with some support from the Obama Administration. Among its negotiating objectives, the legislation includes one on currency. The means listed for addressing currency problems are "cooperative mechanisms, enforceable rules, reporting, monitoring, transparency, or by other means, as appropriate." That list may leave little out, including presumably the status quo, but it hardly paints a clear path for action.

The U.S. automotive industry has been very concerned about bringing Japan into the TPP. It released a proposal that would snap-back tariffs under the TPP to current levels for a country found to be manipulating its currency. The industry proposal drew heavily on the work of the Peterson Institute to fill in some of the details.

A conceptual weakness of this proposal and others like it is the reliance upon envisioned international dispute settlement bodies as first-line decision makers on far-reaching issues, such as snapping back tariffs across the board, which would have significant economic and political ramifications. Since the pool of panelists for membership on such a body would presumably be drawn from the members of TPP—many of which can be accused of currency manipulation—it seems unlikely that they would be able to act with the independence of philosopher kings. Some degree of international scrutiny is likely to be required to prevent abuse, but even with numerical criteria as a primary basis for action, an international dispute settlement body may be unable or unwilling to decide if action is appropriate.

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AN ALTERNATIVE

For the United States and other countries with similar domestic trade regimes, there seems an alternative. Snapping back tariffs to the level before a new agreement was in place does seem a significant and appropriate remedy likely to force attention from offending countries without violating existing U.S. trade commitments. But rather than rely upon an international body as the primary decision maker, the decision could be made by a national authority. A mechanism broadly analogous to a trade safeguard action under current U.S. trade laws in conjunction with WTO rules might be most workable.

In the United States, the process might work like this. A petition for action might be taken either by the President, a joint resolution of Congress, or by a private sector group with broad support. The petition would lay out proof that a designated country was manipulating its currency as measured against its current account position, its foreign currency reserves, and other relevant indicators. It would also show that this manipulation was having a significant adverse impact on the United States.

This petition could be considered by a national body with some independence. The International Trade Commission is certainly an obvious candidate given that it adjudicates other similar trade decisions. Certainly, deciding currency issues would require an expansion of the ITC's expertise, but over the last two decades the ITC's expertise has been expanded from considering trade remedy actions to deciding complex intellectual property issues. This required substantial additions to the ITC's expertise, which could be duplicated for currency issues.

If the ITC decided that conditions had been met to justify a snap-back, the President might be given authority to suspend the snap-back if the country at issue stopped manipulating its currency or action was for other reasons not in the national interest.

To ensure that there were not meritless or unwarranted mirror image actions, national decisions (other parties to the agreement would likely create similar procedures) should be subject to review under the relevant FTA or trade agreement. As noted, this process is problematic in this context, but perhaps placing a strong burden of proof in favor of actions by national authorities would be sufficient to overcome this problem.

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Over time a process like this might be expanded through negotiation to existing trade agreements, such as the WTO, as well as to the TPP and other new agreements. Negotiations on currency manipulation would be difficult. It would no doubt take longer to complete negotiations like the TPP. But if estimates are correct, currency manipulation is the largest current trade impediment facing the United States—perhaps larger than all others combined. That would seem to make it worth the effort of the President and the Congress. ◆