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Currency Manipulation: Why Something Must Be Done

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Currency manipulation occurs when countries sell their own currencies in the foreign exchange markets, usually against dollars, to keep their exchange rates weak and the dollar strong. These countries thereby subsidize their exports and raise the price of their imports, sometimes by as much as 30-40%. They strengthen their international competitive positions, increase their trade surpluses and generate domestic production and employment at the expense of the United States and others.

About 20 countries, most notably China, have engaged in such practices over the past decade at an annual rate that has averaged $1 trillion in recent years. The U.S. trade deficit has been several hundred billion dollars a year higher as a result and we lost several million additional jobs during the Great Recession. Currency manipulation is, by far, the world's most protectionist international economic policy in the 21st century, but neither the U.S. government nor the responsible international institutions, the International Monetary Fund and the World Trade Organization, have mounted effective responses. Congress has therefore been expressing great concern over the issue and wants to take the occasion of the forthcoming legislation on new U.S. trade agreements, most notably the Trans-Pacific Partnership (TPP), to promote decisive counteraction.

Dan Ikenson's critique of my views on implementing effective new constraints on such competitive devaluation policies ("Currency Manipulation and the TransPacific Partnership: What Art Laffer, Fred Bergsten and Other Hawks Get Wrong," January 26) contains several egregious errors that negate his rejection of my policy recommendations. Ikenson writes in the current context of whether the TPP and other pending U.S. trade agreements should include enforceable currency disciplines, but he opposes any action to deal with manipulation of any type so I will respond to his broader arguments.

First, Ikenson excuses the foreign manipulation on the grounds that currency changes do not have much impact on trade flows, citing the continued growth of China's bilateral surplus with the U.S. But he ignores the fact that the 40% rise of the RMB over the past ten years, along with

China’s rapid economic growth, has reduced China’s global current account surplus from 10% of its GDP in 2007 to less than 3% today (which is still much too large as China has continued to manipulate). Currency changes matter hugely for trade balances and the manipulators know it—that is why they manipulate.

Second, Ikenson charges that my recommendations would “only” counter the impact of foreign manipulation on U.S. imports and “do nothing to remedy the distortions on the export side.” To the contrary, my preferred alternative of countervailing currency intervention, as clearly described in all three of my publications cited by Ikenson, would have the U.S. buy foreign currencies in amounts equal to the amounts of dollars the foreigners buy to weaken those currencies. Such U.S. action would offset the effect of the foreign intervention on the exchange rate itself and thus, on U.S. exports as well as imports. Adoption of such a policy by the U.S. would neutralize, and should deter, such manipulation in the future.

Third, Ikenson argues that direct intervention in the currency markets “has no practical differences” from altering exchange rates through quantitative easing (QE) or other economic policy measures. But the two are enormously different; QE and other monetary changes aim directly at the domestic economy using domestic policy instruments, with any impact on exchange rates as a secondary or derivative effect, while currency intervention aims squarely at the exchange rate via operations in foreign instruments. The IMF and G7 have reached full agreement on this distinction and the IMF has shown that one country’s QE helps other countries by strengthening the former’s economy and thus markets for the latter’s exports.
Fourth, Ikenson notes that rising trade deficits often correlate with strong economic growth and job creation. A booming economy of course sucks in imports. But foreign manipulation of a country’s currency weakens its competitiveness and shifts economic activity, including employment, from home to abroad.

Finally, Ikenson criticizes me for “changing my mind” on whether the U.S. should start treating currency manipulation as a foreign export subsidy subject to our countervailing duty laws, as would be mandated by legislation introduced recently in both Houses of Congress. As noted above, I prefer countervailing currency intervention because it would deal with both sides of the trade account rather than imports alone. But manipulation is a blatant export subsidy and should be treated like all such subsidies under our trade laws. I have noted that calculation of the amount of undervaluation of the foreign currency, the basis for determining the amount of the countervailing duty, is difficult but so are many other export subsidies and this one should be no harder to implement.

Currency manipulation is clearly the most economically distortive and protectionist policy measure that has been deployed around the world in recent years. Hence it is surprising and deeply disappointing that free-market enthusiasts such as Ikenson defend the practice and reject practical remedies for countering it. Congress is correct to focus attention on the issue and the pending trade legislation offers a unique opportunity to take decisive action.