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Exchange Rates and Currency Manipulation

An exchange rate is the price of one currency in terms of another currency. Exchange rates are some of the most important prices in the global economy: they affect international trade and financial flows and the value of every overseas investment.

Policymakers have long expressed concerns that a country may intentionally weaken the value of its currency in order to boost exports at the expense of other countries. The United States has sought to counter so-called currency manipulation through a variety of policy tools. Currency manipulation is a controversial concept; there is debate about if, and if so how, it can be effectively addressed.

Frameworks to Address Currency Manipulation

International Monetary Fund

Concerns about unfair exchange rate practices are rooted in the experiences of the 1930s, when countries repeatedly devalued their currencies to boost exports in response to widespread high unemployment and negative economic conditions. Competitive devaluations of the 1930s are widely viewed as contributing to the Great Depression.

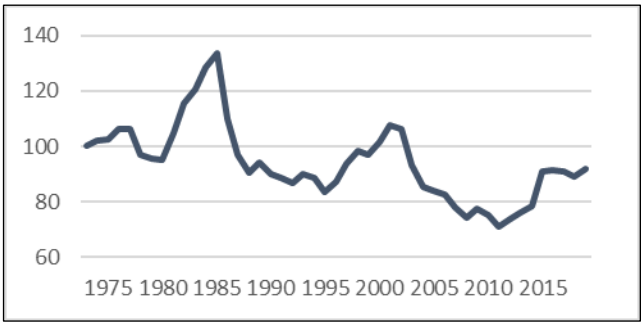
After World War II, countries created a new international organization—the **International Monetary Fund (IMF)**—to promote stability in the global monetary system. As part of joining the IMF, member countries agreed, among other commitments, to refrain from manipulating their exchange rates to gain an unfair trade advantage. A violator could face loss of IMF funding, suspension of its voting rights at the IMF, or, ultimately, expulsion from the institution.

In its eight-decade history, the IMF has never publicly determined a member to be manipulating its currency. Some analysts argue that it is difficult to establish the "intent" for an unfair trade advantage under the IMF's definition of currency manipulation, and that the consequences for currency manipulation are too draconian to invoke.

Informal Economic Policy Coordination

U.S. concerns about currency manipulation resurfaced during the 1980s, when the U.S. dollar appreciated against other currencies (**Figure 1**). The United States utilized informal forums for economic coordination to address its concerns. In 1985, the Group of 5 (G5, France, West Germany, Japan, the United States, and the United Kingdom) signed the **Plaza Accord**, in which countries agreed to intervene in currency markets to depreciate the U.S. dollar in relation to the Japanese yen and the German deutsche mark. In 1987, six countries (the G5, plus Canada) signed the **Louvre Accord**, in which they agreed to halt the depreciation of the U.S. dollar through a host of different policy measures, including taxes, public spending, and interest rates.

Figure 1. Trade Weighted U.S. Dollar Index
Major Currencies, Goods (1973=100), 1973-2019



Source: Federal Reserve.

The United States continues to pursue coordination on exchange rate issues in the contemporary versions of these forums: the **G7** (a small group of advanced economies) and the **G20** (a larger group of major advanced and emerging-market economies). G7 and G20 statements routinely include exchange rate commitments, such as for market-determined exchange rates and to refrain from competitive devaluations. Commitments made in the context of the G7 and the G20 are non-binding.

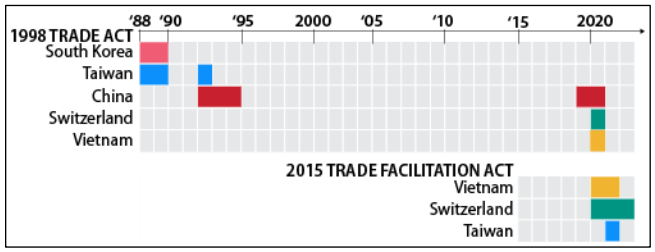
> "Treasury continues to press other economies to uphold the exchange rate commitments they have made in the G20, the G7, and the IMF." *Treasury Department, Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States, June 2022.*

1988 Trade Act

Congress also addressed its concerns during the 1980s about the exchange rate policies of other countries through the **1988 Trade Act** (P.L. 100-418). This Act requires the Treasury Department to analyze and report semiannually on the exchange rate policies of major U.S. trading partners. If 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.

After the legislation was enacted, the Treasury Department initially made several designations: Taiwan in 1988, South Korean in 1988, China in 1992, and Taiwan again in 1992 (**Figure 2**). Designations lasted for a few months to a few years. The Treasury Department did not find any country to be manipulating its currency for more than two decades (1995-2018), although some U.S. policymakers and analysts maintained that some countries, particularly China, merited such a designation. The Treasury Department designated China in August 2019 under the terms set out in the 1988 Trade Act, and the designation was lifted as part of the "Phase One" trade deal with China in 2020. Switzerland and Vietnam were designated in December 2020, and designations were lifted in 2021.

Figure 2. Currency Manipulation Designations



Source: Created by CRS from Treasury Department.

2015 Trade Facilitation and Trade Enforcement Act

Given some Members' continuing concerns about currency manipulation and what they perceived as inaction by the Treasury Department on currency issues, Congress passed new provisions on currency manipulation in the **Trade Facilitation and Trade Enforcement Act of 2015** (P.L. 114-125). The Act provides a specific definition of currency manipulation and mandates actions to address such currency manipulation. Specifically, Treasury is to engage in enhanced bilateral engagement and, if currency manipulation persists longer than a year, enact a number of remedial actions, such as raising the issue at the IMF and prohibiting procurement contracts with the country in question. The Treasury Department has designated Switzerland, Taiwan, and Vietnam for currency manipulation under the 2015 Trade Facilitation Act at various points (**Figure 2**).

Trade Negotiations and Agreements

In 2015, Congress directed the Executive branch to include exchange rate issues in its trade negotiations. Specifically, in 2015, Congress included currency as a principal negotiating objective in **Trade Promotion Authority** legislation (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. The TPA expired in July 2021.

Since 2015, Treasury has negotiated currency issues in the context of the **United States-Mexico-Canada Agreement** (which entered into force in July 2020) and the **"Phase One" trade deal with China** (signed in January 2020). Treasury also negotiated an agreement on exchange rates with the other 11 other Trans-Pacific Partnership (TPP) countries, but it did not enter into force because President Trump withdrew the United States from the TPP in 2017.

Tariffs on Imports from Countries with Undervalued Exchange Rates

In 2020, the **Commerce Department** implemented a regulatory change that attempts to counter currency manipulation through tariffs. The regulation allows, in certain circumstances, tariffs on imports from countries determined by the Commerce Department, in consultation with the Treasury Department, to be undervaluing their currency. Various Members of Congress had debated such a policy for years, 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 2021, the Commerce Department announced its first affirmative finding regarding a currency-related subsidy involving tires from Vietnam, and imposed a countervailing duty rate of 6.46%.

Section 301 Investigation

In October 2020, the U.S. Trade Representative (USTR) announced a "Section 301" investigation into Vietnam's currency practices. Section 301 of the 1974 Trade Act (P.L. 93-618) grants USTR a range of responsibilities and authorities to investigate trade practices that may violate U.S. trade agreements or engage in acts that are "unjustifiable," "unreasonable," or "discriminatory" and burden U.S. commerce, and potentially impose trade sanctions. The application of Section 301 to currency issues is unprecedented and controversial. In January 2021, USTR determined that Vietnam had taken "unreasonable" actions to push down the value of its currency, but did not impose retaliatory tariffs. In July 2021, Vietnam's central bank, in a joint statement with U.S. Treasury Secretary Janet Yellen, pledged not to manipulate the currency to gain an unfair advantage, and USTR subsequently terminated the Section 301 investigation.

Policy Issues for Congress

Since 2015, the United States has significantly expanded its policy tools for responding to currency manipulation and, for the first time in decades, actively pursued allegations of currency manipulation against multiple countries. Questions Congress might consider are as follows.

- The United States has deep and liquid foreign exchange and capital markets, and trillions of dollars are exchanged for foreign currencies daily. To what extent can other countries successfully lower the value of their currency relative to the dollar?
- Many economic policies can impact exchange rate levels. Is it possible to differentiate currency manipulation from "legitimate" economic policies?
- Even though U.S. producers generally find it harder to compete when other countries have weak currencies, U.S. consumers generally benefit from less expensive imports. What are the net effects of currency manipulation on the U.S. economy?
- In addition to U.S. commitments on currency at the IMF and the G and G20, U.S. laws and regulations contain multiple definitions of currency manipulation. Is the United States sending a clear signal to its trading partners about what constitutes currency manipulation and what the consequences are?
- Does a unilateral approach help the United States gain traction on currency issues? What are the retaliatory risks? Should the IMF play a stronger role in resolving currency disputes?
- Are trade agreements an effective tool for addressing currency issues? Should currency manipulation be addressed if Congress renews TPA?
- How does the dollar's appreciation since mid-2021 impact debates about currency manipulation?

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