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TPP and Exchange Rates

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The Trans-Pacific Partnership (TPP) has achieved an important distinction in the history of trade policy. It is the first ever free trade agreement linked explicitly to macroeconomic policies and exchange rates. The Joint Declaration of the Macroeconomic Policy Authorities of Trans-Pacific Partnership Countries, while not part of the TPP agreement itself or covered by its dispute settlement procedures, is an important step toward discouraging or even preventing countries participating in the pact from intervening in exchange markets to gain trade advantages through the manipulation of their currency values.[1] In addition, the Trade Facilitation and Trade Enforcement Act (discussed below), which President Barack Obama signed into law in February 2016, further improves the United States' ability to combat currency manipulation by trading partners. More specifically, the new law requires the Treasury to undertake "enhanced engagement" and follow-up actions with countries that persistently manipulate their currency values and rack up large current account surpluses as a result. Its language effectively strengthens the Treasury's tools to deal with the problem.

Despite these agreements and actions, many in Congress—and several presidential candidates—continue to disapprove of the TPP on the ground that it lacks adequate protections against currency manipulation. Until recently China was a major currency manipulator. Although it is not a signatory to the TPP, opponents of the trade deal say they want to guard against the possibility that

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1. For the full text, see "Joint Declaration of the Macroeconomic Policy Authorities of Trans-Pacific Partnership Countries," www.treasury.gov/initiatives/Pages/joint-declaration.aspx.

it might join in the future and return to its earlier currency practices. Critics want to establish the toughest possible provisions on this issue to deter future abuses.

This chapter argues that the joint declaration on currency and the new Trade Facilitation and Trade Enforcement Act have achieved significant progress in the cause of stopping currency manipulation. The commitments in the declaration, for example, are far-reaching in rejecting competitive devaluations and persistent exchange rate misalignments. In addition, the requirements for more transparency and public disclosure of data on exchange rate policies, including currency intervention, should make the "naming and shaming" of manipulators more effective. The declaration, released with the TPP text on November 5, 2015, taken together with new trade legislation passed by Congress in February 2016, should thus strengthen the Treasury Department's ability to deter currency manipulation by the United States' trading partners, including any future members of the TPP. That said, currency manipulation remains an important concern in international trade, but it should not become a reason for opposing the TPP.

The term *currency manipulation* usually refers to actions taken by a country to artificially depress the value of its currency. A country does so by buying dollars, in order to keep the currency from rising, which increases its exports and reduces its imports. The practice was widespread during the decade preceding 2012–13, averaging as much as $1 trillion annually and producing large trade surpluses in China and other countries. The economic effects on the United States and other deficit countries were highly adverse.[2]

Manipulation declined dramatically over the past decade, especially by the major economies in Asia, virtually disappearing in 2015 and early 2016. China and a number of former manipulators have, in fact, been selling dollars to keep their exchange rates from falling more sharply, and worries about the economic weakness of many of those countries have superseded earlier fears of their competitive strength. *Very few, if any, countries, whether or not members of the TPP, could be indicted for currency manipulation at the current time.*

It would, nevertheless, be highly desirable to put new rules and policies in place to deal with currency manipulation and deter any recurrence of past policies. World trade rules have long obliged countries to avoid currency manipulation because it dilutes the impact of negotiated liberalization. But enforcement of these obligations depends on certification by the International Monetary Fund (IMF) that a country's exchange rate policies were contravening IMF obligations to avoid competitive devaluation as well as distorting trade flows. No multilateral enforcement actions to counter currency manipulation have been taken in the 70-year history of the postwar economic system.

Concerned about the past currency practices of China, Japan, and other

2. See C. Fred Bergsten and Joseph Gagnon, *Currency Manipulation, the US Economy, and the Global Economic Order,* PIIE Policy Brief 12-25, December 2012, Peterson Institute for International Economics, Washington.

US trading partners, Congress adopted two principal negotiating objectives regarding exchange rates when it enacted Trade Promotion Authority (TPA) in June 2015 authorizing President Obama, inter alia, to negotiate and ratify the TPP. With respect to currency practices in general, the TPA set as a principal objective of the TPP "that parties to a trade agreement with the United States avoid manipulating exchange rates in order to prevent effective balance of payment adjustment or to gain an unfair competitive advantage over other parties to the agreement...." With respect to unfair currency practices, the principal objective should be "to seek to establish accountability through enforceable rules, transparency, reporting, monitoring, cooperative mechanisms, or other means to address exchange rate manipulation involving protracted large-scale intervention in one direction in the exchange markets and a persistently undervalued foreign exchange rate to gain an unfair competitive advantage in trade over other parties to a trade agreement." These objectives are to be pursued consistent with IMF and World Trade Organization (WTO) obligations.

The new accord on currency is in the Joint Declaration of the Macroeconomic Policy Authorities of Trans-Pacific Partnership Countries. It contains commitments by each TPP member to "foster an exchange rate system that reflects underlying economic fundamentals," "avoid persistent exchange rate misalignments," and "refrain from competitive devaluation." To increase the prospect that macroeconomic authorities will meet these objectives, the joint declaration requires each country to make regular and public disclosures of its foreign exchange reserves, interventions in spot and forward currency markets, portfolio capital flows, and related actions. Some participants (Brunei, Malaysia, Singapore, and Vietnam) will comply with these obligations with a delay or only in part.

In addition, the joint declaration establishes a new Group of TPP Macroeconomic Officials to monitor the exchange rate and macroeconomic policies of the TPP countries. The member countries are to meet together at least annually and issue reports on "that meeting and any conclusions that reflect the collective views of the Group." Along with the augmented data, such reviews can be timely and effective in helping to deter currency manipulation.

The consultations on macroeconomic policies can and undoubtedly will address monetary policies such as quantitative easing (QE), as practiced recently by the United States and currently by Japan, as well as direct intervention in the currency markets. Some US officials and members of Congress have expressed concern that other countries might seek to characterize QE as "currency manipulation," on the ground that it can lead to currency depreciation. It is certainly possible that some countries might raise that issue. But there is widespread international agreement that there are fundamental differences between QE and manipulation. QE pursues domestic economic goals through the use of domestic policy instruments, whereas manipulation refers to direct intervention in the markets for foreign currencies to affect the trade balance. QE increases global as well as domestic demand by increasing the growth of the country involved, whereas manipulation simply shifts demand from one country to another by reorienting and indeed distorting trade flows. QE thus strengthens the economies of trade partners, whereas manipulation weakens them. Accordingly, the fear that the new declaration and its consultative group could successfully challenge the use of macroeconomic policy instruments by the United States or any other TPP member is groundless.

These new commitments will take effect upon entry into force of the TPP, which will, therefore, increase the arsenal of tools to counter currency manipulation. Adhering to this declaration will be a requirement for countries that seek to accede to the pact in the future.

The commitments undertaken in the joint declaration are not enforceable through the dispute settlement procedures of the TPP, as advocated in amendments to the TPA that were narrowly defeated in the US Senate. The negotiators opted for an early warning system via enhanced reporting requirements and frequent monitoring and consultations to deter future episodes of currency manipulation instead of the "hard deterrence" approach preferred by some members of Congress, which would have involved binding dispute settlement, with the possible imposition of trade sanctions against the offending country. The Obama administration argued that the latter approach was not negotiable and that an effort to achieve it would have torpedoed the entire TPP negotiation.

The Trade Facilitation and Trade Enforcement Act includes an amendment sponsored by Senators Michael Bennet, Orrin Hatch, and Tom Carper—worked out with the administration—that significantly expands Congress' mandate to the administration on these issues.[3] It requires the Treasury to launch "enhanced engagement" with major trading partners of the United States that meet several objective criteria: a significant bilateral trade surplus with the United States, a material current account surplus, and engagement in persistent one-sided intervention in the foreign exchange market (the assessment of which should be substantially aided by the disclosure commitments in the joint declaration). This use of objective criteria represents a significant improvement over the operational language of the previous legislation, which required subjective judgment of countries' intent in determining whether to designate them formally as "currency manipulators."

The new law further requires that the president implement one or more of four specific policy measures against designated countries that do not adopt corrective policies within a year, presumably judged against the same set of objective criteria. One of these measures is that the US Trade Representative (USTR) "take into account" such a country's currency practices in determining whether to include that country in future US trade agreements. These new US legal requirements apply to all trading partners of the United States, not just

3. The currency chapter of the Trade Facilitation and Trade Enforcement Act, although it was passed several months later, was explicitly seen as part of the trade policy package that enabled Congress to pass Trade Promotion Authority in the summer of 2015.

those participating in the TPP or other US trade agreements. The Treasury will provide an initial clue on how it plans to implement its new mandate when, as required by the amendment, it "publicly describes" by May 2016 "the factors used to assess" the key terms and concepts in the law.

In sum, the joint declaration and the Bennet-Hatch-Carper amendment to the new trade legislation substantially meet the negotiating objectives set out in the TPA.[4] The Treasury should now be more effective in deterring TPP (and other) countries from embarking on new episodes of currency manipulation. Added together, these measures protect the trade deal's benefits for the United States and the world economy.

Doubts, nevertheless, remain in some quarters that the steps adopted so far are adequate to address the manipulation problem. Presidential candidates of both parties have cited the absence of stronger disciplines on manipulation as a chief reason for their opposition to the TPP as a whole (though none of them has recognized that the practice of manipulation virtually disappeared over the past two years). So have a number of members of Congress, including Republican Senator Rob Portman of Ohio, USTR under President George W. Bush and a strong supporter of TPA last summer, who recently announced his opposition to the TPP largely because of this issue.

It is virtually inconceivable that the TPP could be renegotiated to include "enforceable currency disciplines," or any other major new issue, now that the agreement has been signed by the 12 participating countries and several of their parliaments have begun the ratification process. Any effort to do so would unravel the whole agreement. Even if a meaningful currency chapter could be added, the United States would have to give up many of its important and hard-won concessions on other issues in return. In any event US currency objectives are better served by policies that apply to all of its trading partners, as with the Bennet-Hatch-Carper amendment, rather than just the subset involved in the TPP. Some of the major sources of previous manipulation, notably China, are not members of that agreement (although they might conceivably join at some point in the future).

If additional steps are necessary to achieve passage of the TPP, US officials and congressional leaders could turn to other options available under domestic law for deterring currency manipulation that are consistent with US international obligations. One policy option, initially proposed by one of us (C. Fred Bergsten), would be an announcement by the Treasury Department that it would henceforth fight fire with fire, carrying out countervailing currency intervention against countries that sought to depress their exchange rates against the dollar, as included (as "remedial currency intervention") in the currency bill passed by the Senate in 2011. The Treasury could do so by buying the currencies of manipulators in amounts equal to their purchases of dollars. This approach

4. As argued by the majority of the president's Advisory Committee for Trade Policy and Negotiations (ACTPN) in its report on the Trans-Pacific Partnership to the president and Congress in December 2015.

would neutralize the impact of the manipulation and effectively deter any such efforts. Very little if any countervailing intervention would, therefore, ever have to be actually carried out, with the possible exception of an initial salvo or two to demonstrate the credibility of the new US policy. The Obama administration has so far not supported this policy.

Another widely discussed option is to revive the idea of applying countervailing duties against imports subsidized by currency manipulation, as passed by the Senate in its initial version of the Trade Facilitation and Trade Enforcement Act (and previously by the House in 2010 and the Senate in 2011) but dropped from the conference report before final passage. The argument in favor of this approach is that currency manipulation has the same effect on traded goods as subsidies that are routinely subject to countervailing duties. However, WTO rules do not define manipulation as a countervailable subsidy, and the application of such duties based on calculations of currency manipulation would almost certainly be challenged by offending countries and lead them to retaliate against US exports. Countervailing duties also have the shortcoming that they would cover only the import side of US trade whereas currency manipulation by other countries adversely affects US exports as well.

In its consideration of the TPP, Congress should take note of the fact that very few, if any, countries in the world trading system are now manipulating their currencies. Accordingly, there would probably be no need to apply new policies to oppose currency manipulation in the near future. The steps adopted so far should also assure Congress and others that the United States would no longer countenance manipulation from TPP partners or other countries in the longer run as well. Members of Congress and a new administration who are genuinely concerned about the problem should thus support the TPP without fear that its benefits might be diluted by currency manipulation.