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## Peterson Institute's Study by Bergsten and Gagnon Proposes New Strategy to Counter Currency Manipulation

WASHINGTON—Global imbalances and the threat of currency conflict have plagued the world economy for many years, reaching a new peak over the 2003 to 2013 period. Concerns about currency manipulation became a major issue in recent congressional trade policy debates and even in the US presidential election of 2016. But until now the costs of recent clashes over currency have not been rigorously quantified. Today the Peterson Institute for International Economics is publishing an important new study that finds currency manipulation by China and a number of other countries totaled over \$600 billion per year during the 10-year period. The study, *Currency Conflict and Trade Policy* by C. Fred Bergsten and Joseph E. Gagnon of the Peterson Institute, estimates that this massive intervention caused the United States to run about \$200 billion in higher trade deficits annually, cost more than 1 million jobs during and after the Great Recession, and was a factor in causing the recession and in slowing the recovery from it. The authors say that currency manipulation by China accounted for perhaps a third of the US job displacement from the rapid growth in Chinese imports after 2001, a development that has contributed to the backlash against trade agreements and globalization more broadly.

*Currency Conflict and Trade Policy* provides a sweeping analysis of what it calls a historic failure to curtail these practices by the international economic system. It details the inadequacy of existing US policy and proposes a range of solutions to deal with the problem in the future. US authorities have made some progress in the last few years by getting G-7 and G-20 countries to agree to stop intervening in the currency markets to gain competitive advantage. Manipulation has gone largely into remission over the past two years, reflecting market forces but perhaps also some peer pressure. It is unclear however that countries would refrain from manipulating if market forces change direction and their trade surpluses are threatened.

Manipulation occurs by the authors' definition when countries intervene in the foreign exchange markets to keep the value of their currencies artificially low in order to lower the prices of their exports and raise the prices of their imports. They do so by selling their own currencies and buying dollars. To prevent this practice in the future, Bergsten and Gagnon propose objective criteria to determine when a country is manipulating and how the United States should react when one does. The currency chapter of the Trade Facilitation and Trade Enforcement Act of 2015, which is now the basis of US policy on this issue, adopts important elements of their criteria but could go further, in the view of the authors.

Bergsten and Gagnon argue that the United States should implement a new policy of "countervailing currency intervention" (CCI) against all systemically important (G-20) countries. Under such an approach, the United States would announce that it would offset the effects of currency manipulation through equal purchases of the intervening country's currency. This is intended to deter any return of the practice and, like any deterrent if credible, probably would not have to be used much if at all.

They further call on the United States to include the currency issue in future trade agreements, including the possible renegotiations of the North American Free Trade Agreement (NAFTA) and the Korea-US trade pact, and future trade deals with Japan, Europe, and Britain. The United States should also take manipulators to the World Trade Organization (WTO) to

authorize trade sanctions against them. To address systemic issues, they also propose that the International Monetary Fund (IMF) adopt agreed normative ranges for trade balances and rules on foreign exchange intervention that would prohibit countries from maintaining excessive trade surpluses or deficits. Finally, they propose the establishment of a new special drawing rights (SDR) council, comprised of the five authorities (China, euro area, Japan, United Kingdom, United States) whose currencies make up the Fund's SDR, to consult on intervention issues.

Bergsten and Gagnon conclude by saying that the current period of remission in currency manipulation should not lead to complacency—given the costs of such manipulation that they newly estimate. Rather they say that now is the time to erect effective barriers to a return of these problems. “Fred and Joe’s innovative policy proposals for the United States to deter currency manipulation in the future and for the IMF to change the rules, constructively address a serious fairness gap in the global economy, especially for the dollar as the anchor currency. For the congressional concerns over trade, this book provides a basis for addressing one area of legitimate complaint,” said Adam S. Posen, PIIE president. “Their test that determines when a country is manipulating its currency against the dollar wisely has been largely adopted by the US Treasury already. Currency manipulation dislocates jobs in nonmarket ways and is significantly harmful in a time of recession, as was the case in 2008–10. The US government should listen further to Bergsten and Gagnon, and take action to discourage unfair currency practices in the future.”

*Currency Conflict and Trade Policy: A New Strategy for the United States*

C. Fred Bergsten and Joseph E. Gagnon

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## ABOUT THE AUTHORS

C. Fred Bergsten, senior fellow and director emeritus, was the founding director of the Peterson Institute for International Economics (formerly the Institute for International Economics) from 1981 through 2012. He is serving his second term as a member of the President’s Advisory Committee for Trade Policy and Negotiations. He was chairman of the Eminent Persons Group of the Asia Pacific Economic Cooperation (APEC) forum (1993–95) and assistant secretary for international affairs of the US Treasury (1977–81). He has authored, coauthored, edited, or coedited 44 books on international economic issues, including *International Monetary Cooperation: Lessons from the Plaza Accord after Thirty Years* (2016), *The Long-Term International Economic Position of the United States* (2009, designated a “must read” by the Washington Post), and *The United States and the World Economy: Foreign Economic Policy for the Next Decade* (2005).

Joseph E. Gagnon is senior fellow at the Peterson Institute for International Economics. He was visiting associate director, Division of Monetary Affairs (2008–09) at the US Federal Reserve Board, where he was also associate director, Division of International Finance (1999–2008), and senior economist (1987–90 and 1991–97). He has served at the US Treasury Department (1994–95 and 1997–99) and taught at the Haas School of Business, University of California, Berkeley (1990–91). He is the author of *Flexible Exchange Rates for a Stable World Economy* (2011) and *The Global Outlook for Government Debt over the Next 25 years: Implications for the Economy and Public Policy* (2011).

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