
The Exchange Rates and International Economic Policy Coordination Act of 1988

As a prelude to examining the usefulness of the exchange rate reporting process, a review is in order of the origins of the Exchange Rates and International Economic Policy Coordination Act of 1988 and its key elements. This legislation is reproduced in appendix A. It was passed as part of the much larger, and better known, Omnibus Trade and Competitiveness Act of 1988.

Origins

The 1988 Act was forged in the heat of the international trade and monetary conflicts of the mid-1980s. During the early part of that decade, the United States pursued a combination of loose fiscal policy and tight monetary policy that came to be called the “Reagan-Volcker” policy mix. The mix produced an appreciation of the dollar and trade and current account deficits that set new records. Rather than alter domestic macroeconomic policy in light of these external consequences, the first Reagan administration actively encouraged capital inflows to finance the fiscal and current account deficits. These policies produced a flood of imports and pressure on traded goods producers that was unprecedented in the postwar period. When these interest groups complained to the US Treasury, Secretary Donald T. Regan and his Undersecretary for International Affairs, Beryl W. Sprinkel, told them that Treasury would not attempt to cap the

value of the dollar for their benefit. These groups then brought their complaints to Congress.¹

Congress responded in three ways. First, a number of committees held hearings on the issue, raising public consciousness and building a case for policy action. Second, several members proposed trade legislation that would favor domestic industry. Resentment of the administration's trade policy ran so deep that one protrade member claimed, hyperbolically, that the House of Representatives would have passed the Smoot-Hawley bill had it been brought to the floor during the summer of 1985. Third, members of Congress proposed legislation that would require the Treasury and Federal Reserve to address the exchange rate.

Such legislation went through two phases. The first set of bills would have required these agencies to intervene in the foreign exchange market in prescribed amounts to depress the value of the dollar. These bills were impractical, but they forced the administration to take the sentiments of the Congress on this issue seriously. The chairman of the Ways and Means Committee, Dan Rostenkowski (D-IL), proposed an "exchange rate equalization tariff" directed at newly industrialized economies (NIEs) that maintained undervalued currencies—a precursor to similar bills before the present Congress. The second set of bills endeavored to make the executive more accountable with respect to exchange rate and related policy, more responsive when a broad set of private interests object to the value of the dollar, and more vigilant with respect to specific countries that maintained undervalued rates.

During 1985, James A. Baker III, who had replaced Donald Regan as secretary of the Treasury at the outset of the second Reagan administration, addressed the issue by launching the process that resulted in the Plaza Accord of September of that year and the Louvre Accord of February 1987. This process produced—or, depending on one's view of the effectiveness of government action in this domain, contributed to—a dramatic depreciation of the dollar and then a partial stabilization. It was coupled by an effort, more effective in some cases than in others, to alter monetary and fiscal policies among partners as well as at home to contribute to the adjustment of current account imbalances (see Funabashi 1988, Frankel 1995). Baker's actions bought time and some goodwill on Capitol Hill, which allowed the administration to defang some of the more protectionist elements from what was to become the Omnibus Trade and Competitiveness Act of 1988. However, a number of currencies, notably the New Taiwan dollar and the Korean won, remained undervalued even as they appreciated in bilateral nominal terms against the US dollar, given the dollar's depreciation against the yen and European

1. For a review of this episode, see Destler and Henning (1989); Henning (1994); and Destler (2005).

currencies.² So the sponsors of the 1988 Act sought, among several other things, to appreciate such undervalued currencies as well as to prevent a repeat of the policies of the first Reagan administration.

The drafters of the exchange rate legislation looked to the IMF's Articles of Agreement for a statement of members' obligations with respect to exchange rates. Article IV states in part, "In particular, each member shall . . . avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. . . ." This passage, introduced with the second amendment to the Articles of Agreement after the transition to floating exchange rates in the 1970s, provided the basis for special consultations with Sweden in 1982 and Korea in 1987 when their policies became suspect. However, the Fund has never cited a member for manipulation. The Executive Board had established guidelines that Fund staff were to follow in surveillance of members' exchange rate policies, including specific criteria that could indicate proscribed manipulation (Article IV and the 1977 guidelines, as amended through June 2007, are reproduced in appendices B and C, respectively).³ For the section of the 1988 Act that addressed the currency policies of the East Asian NIEs, the drafters borrowed heavily from the language of Article IV.

Key Elements

The 1988 Act contains six sections, 3001 to 3006, devoted respectively to short title, findings, statement of policy, international negotiations, reporting requirements, and definitions.⁴

In section 3002, Congress found that patterns of exchange rates contributed to trade and current account imbalances, and that this was true in particular of the appreciation of the dollar during the early 1980s, "imposing serious strains on the world trading system and frustrating both business and government planning." Currency manipulation on the part of some "major trading nations" continued to create "serious" competitive problems for US industry. A "more stable exchange rate" at a level consistent with "a more appropriate and sustainable" balance in the current account should be "a major focus of national economic policy." Macroeconomic policy coordination and foreign exchange intervention could be useful tools to that end.

2. See C. Fred Bergsten, statement before the Hearing on Currency Manipulation, Subcommittee on International Trade, Committee on Finance, United States Senate, Washington, May 12, 1989. See also Balassa and Williamson (1990).

3. See also Goldstein (2006) and Mussa (2007).

4. The Act is reproduced in appendix A.

Section 3003 states that “[i]t is the policy of the United States that” the United States and its partners should continue the process of coordinating “monetary, fiscal, and structural policies” begun with the Plaza Accord. The goal of the United States in international economic negotiations should be “to achieve macroeconomic policies and exchange rates consistent with more appropriate and sustainable balances in trade and capital flows and to foster price stability in conjunction with economic growth.” The United States and its partners should intervene, “in combination with necessary macroeconomic policy changes,” to bring this about. While recognizing that the exchange rate and balance of payments were embedded in a broader macroeconomic framework, Congress intended for the exchange rate and the level of foreign borrowing to become matters of conscious policy (US Congress 1988, 84). The section adds, pointedly, that “the accountability of the President for the impact of economic policies and exchange rates on trade competitiveness should be increased.”

Section 3004 addresses two levels of negotiations: (1) multilateral, where the president is directed to “seek to confer and negotiate” to achieve these objectives; and (2) bilateral, the heart of the antimanipulation provisions. Under the bilateral negotiations subsection, the Act directs the secretary of the Treasury to “analyze on an annual basis” the exchange rate policies of other countries for evidence of manipulation against the dollar “for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.” This language adhered deliberately, though not exactly, to Article IV of the IMF Articles of Agreement and, like that article, did not define “manipulation” further. (Within the IMF, guidance on this definition was provided in principles that were adopted by a decision of the Executive Board, as discussed below.)

The secretary is to apply a three-part test. If a country (1) manipulates its rate, (2) runs “material global current account surpluses,” and (3) has “significant bilateral trade surpluses with the United States,” then the secretary “shall take action to initiate negotiations with such foreign countries on an expedited basis” in the Fund or bilaterally, to ensure that the cited country “regularly and promptly” adjusts its exchange rate to eliminate the unfair advantage and permit balance of payments adjustment. These negotiations will likely produce results only with the assent of foreign counterparts. Legislation can require only that the secretary approach counterparts for negotiations, but if the negotiations yield little, the secretary is expected to explain.

Notably, the secretary is not required to initiate negotiations in cases where they would have a “serious detrimental impact on vital national economic and security interests,” but would have to inform the chairpersons and ranking members of the banking committees of both houses of such a determination. This waiver, however, does not relieve the Treas-

surey of a finding of manipulation when circumstances dictate, only of the requirement to pursue negotiations once manipulation is found.

Section 3005 details the reporting requirements. The secretary of the Treasury shall submit a report annually to the banking committees of both houses, on or before October 15, with written six-month updates (on April 15). The department shall consult with the Federal Reserve when preparing the report. The secretary shall testify to the banking committees on the report if requested to do so. The section originally also directed the Federal Reserve, for its part, to analyze the impact of the dollar's exchange rate on the US economy in its semiannual Humphrey-Hawkins reports to Congress—a provision that survived, albeit in amended form, the revision to the Federal Reserve's monetary policy reporting mandate in 2000.⁵

The section specifies a long list of information that Treasury must include in its reports:

- “an analysis of currency market developments” and exchange rates;
- an evaluation of the determinants of exchange rates;
- “a description of currency intervention” and other exchange market actions;
- assessment of the impact of the dollar's exchange rate on the “competitive performance” of “industries,” trade and current account balances, production, growth, employment, and external indebtedness;
- recommendations for “any changes in United States economic policy to attain a more appropriate and sustainable” current account balance;
- the results of negotiations over currency manipulation;
- issues arising in Article IV consultations with the IMF; and
- a report on international capital flows and their effects.

The 1988 Act thus placed a substantial additional burden on the Treasury to collect, analyze, and report these assessments to Congress. In passing this legislation, members of Congress expected Treasury to convey analytical substance that would provide a foundation for meaningful oversight. They also intended that these reports inform the broader public discourse on international economic policy and the external ramifications of domestic monetary and fiscal policies. Above all, they wanted to make it more difficult for Treasury to neglect a strong dollar and undervalued foreign currencies as it had under Secretary Regan. Treasury did not need this legislation to combat currency manipulation on the part of foreign

5. Federal Reserve Act, Section 2B, as amended December 27, 2000, available at www.federalreserve.gov (accessed March 19, 2008).

governments; it had the authority and ability already. The legislation was an effort by members of Congress to provide greater leverage to the department's bargaining position and to prod Treasury to act against manipulation when it might not otherwise do so.

Comparison with IMF Language

There are two important differences between the language of the IMF's Article IV and exchange rate surveillance guidelines, on the one hand, and the United States' 1988 Act, on the other. First, the IMF language is formally symmetrical with respect to overvaluation and undervaluation. Although the IMF staff's interpretation of Article IV emphasized intent to prevent adjustment, which compromised the Fund's ability to enforce manipulation in both directions, countries were in principle enjoined against manipulating the rate to achieve either (IMF 2006, 15; Frankel and Wei 2007). Under the 1988 Act, the designation for manipulation is also symmetrical in principle. But the Treasury is mandated to pursue negotiations only with countries that "(1) have material global current account surpluses; and (2) have significant bilateral trade surpluses with the United States." Negotiations are not mandated for countries running trade and current account deficits. In addition, whereas the IMF focuses on overall current account surpluses, the US legislation also introduces the bilateral trade balance and directs Treasury to consider both. While acknowledging the bilateral balance as politically salient, a large majority of economists regard it as a policy-irrelevant concept in a world of multi-lateral trade (Noland 1997, Frankel and Wei 2007).