

---

# Preface

Currency issues regained their political and economic salience in the years since 2000. Heavy intervention in the foreign exchange markets by a number of countries, most extensively by China, led to widespread charges that such currency manipulation was adversely affecting other economies and the United States, in particular. The record trade imbalances of the first decades of the new century illustrated and fed these concerns about stealing demand and competitive devaluation, especially when global demand was shrinking during the global financial crisis and slow recovery.

From a longer-term perspective, the unilateral exercise of currency intervention highlights the recurring and seemingly inherent failure of the international monetary system to achieve effective adjustment on the part of surplus countries. G-7 and G-20 compacts on exchange rate policy as well as subsequent shifts in countries' relative economic fortunes have meaningfully diminished the exercise of manipulation since 2012, but the underlying problem and risk of renewed tensions remain.

Currency has also become a central issue in the debate over trade policy in the United States, and remains so. Congressional and other critics of further trade liberalization, most notably of the Trans-Pacific Partnership, cited the manipulation issue as a major reason for their opposition, with some justification (as well as some opportunism). New legislation was passed to govern US currency policy, and potential TPP partners and others were prepared for a more forceful approach. The topic was prominent as part of the broader attack on globalization by candidates of both parties during the US political campaigns in 2016, and it has remained on

the agenda of the Trump administration and is even higher on the agenda of trade-concerned Congress members of both parties.

This book analyzes the economics and politics of the currency issue, globally and with respect to the key individual countries that engage in repeated intervention or feel its effects. It shows empirically the strong connection between official foreign exchange intervention and trade imbalances, using new reproducible econometric research. The authors also create a practical definition of currency manipulation, with a relevant objective test of exchange rate policy that the official sector can use for fair assessment (and which the US Treasury has already largely adopted). The book assesses the effects on trading partners of countries that intervene, with a focus on effects on the United States.

The authors argue that currency manipulation accelerated the already rapid technology-driven loss of manufacturing jobs prior to the Great Recession and slowed the economic recovery afterwards. On their estimates, the degree of manipulation-induced dollar overvaluation kept US unemployment higher than it otherwise would have been by roughly a million jobs from 2009 through 2013. To put this impact in perspective, that direct harm came in a US economy of more than 150 million jobs, of which 12.4 million are in manufacturing. That is worth addressing since those manipulation-induced job losses should have been completely avoided, but it was not the primary determinant of US economic outcomes. That said, currency manipulation against the dollar at its height was meaningfully harmful, not least to the support for globalization and trade openness by being visibly unfair. Arguably, China's peak currency manipulation in the years leading up to the 2008 crisis caused much of the currently discussed additional job dislocation in the United States blamed on China. While expanding open and fair trade with China itself inevitably brought some industrial adjustment in the United States, it delivered considerable aggregate income gains. The unfair large-scale currency manipulation pursued by the Chinese government in the early 2000s, however, subtracted from US income and employment with no shared gains and was intentional grabbing of demand rather than the result of market competition. This dynamic underscores why a systemic lasting solution to currency manipulation and conflict is in all countries' long-term interest.

The authors' US focus of analysis and policy recommendations reflects the central role of the dollar, such that interventions and any manipulation primarily target the dollar, and that US policy responses could set rules for or disrupt international trade and currency markets. Starting systematically and analytically, the book develops norms for trade imbalances and recommended limits for currency policies. Importantly, it also explores alternative policies that the key currency-intervening countries could have

adopted to achieve sound economic growth and price stability, without reliance on excessive foreign exchange intervention. Smaller open economies must be offered an alternative path to legitimate goals for domestic economic stability if they are to reduce or forswear currency manipulation. The authors also explore a wide range of potential policy responses in the G-20 and via the International Monetary Fund (IMF) for the United States and other affected countries to undertake to prevent future currency conflict.

Bergsten and Gagnon make innovative proposals for US policies to deter such currency manipulation in future and thereby address constructively one of the more justified congressional concerns about trade liberalization. They propose that the United States take advantage of the current lull in currency intervention to announce a new policy of “countervailing currency intervention,” by which the United States would commit to offsetting the effects of future currency manipulation by any G-20 country through equal purchases of that country’s currency. The United States should also pursue the adoption of stronger and more objective rules, which the authors propose on currency intervention, both in the IMF and in the context of future trade agreements. The authors argue that a strong and credible policy approach now would help to prevent currency conflicts from heating up again and help to safeguard the global trading system.

The Peterson Institute for International Economics is a private nonpartisan, nonprofit institution for rigorous, intellectually open, and in-depth study and discussion of international economic policy. Its purpose is to identify and analyze important issues to making globalization beneficial and sustainable for the people of the United States and the world, and then to develop and communicate practical new approaches for dealing with them.

The Institute’s work is funded by a highly diverse group of philanthropic foundations, private corporations, public institutions, and interested individuals, as well as by income on its capital fund. About 35 percent of the Institute’s resources in our latest fiscal year were provided by contributors from outside the United States. This study received generous support from the Smith Richardson Foundation for independent research on this crucial topic. A list of all our financial supporters for the preceding year is posted at <http://piie.com/institute/supporters.pdf>.

The Executive Committee of the Institute’s Board of Directors bears overall responsibility for the Institute’s direction, gives general guidance and approval to its research program, and evaluates its performance in pursuit of its mission. The Institute’s President is responsible for the identification of topics that are likely to become important over the medium

term (one to three years) that should be addressed by Institute scholars. This rolling agenda is set in close consultation with the Institute's research staff, Board of Directors, and other stakeholders.

The President makes the final decision to publish any individual Institute study, following independent internal and external review of the work. Interested readers may access the data and computations underlying the Institute publications for research and replication by searching titles at [www.piie.com](http://www.piie.com).

The Institute hopes that its research and other activities will contribute to building a stronger foundation for international economic policy around the world. We invite readers of these publications to let us know how they think we can best accomplish this objective.

ADAM S. POSEN  
President  
April 2017