



# **ACCOUNTABILITY AND OVERSIGHT OF U.S. EXCHANGE RATE POLICY**

C. Randall Henning

Peterson Institute for International Economics

June 19, 2008

# Outline

- Central Problem
- Accountability framework
- Empirical findings
- Recommendations

# The Central Delegation Problem:

How to minimize deviation of the agent from the preferences of the principal—“bureaucratic drift” —in the presence of information asymmetry.

# Debate over the role of Congress in exchange rate policy

- Technocratic view:
  - Members of Congress do not understand this issue area.
  - They can be captured by special interest groups.
  - They “grandstand” and “demagogue” to impress voters.
  - Their attention waxes and wanes.
  - They are sometimes simply protectionist.
  - Assignment of exchange rate policy to the Congress rather than the Executive is an inconvenient artifact of American political history.
  - Exchange rate provisions of the 1988 trade act were a mistake.

## My argument:

- Accept that Congress as the source of authority on exchange rate policy; build a functional relationship to Treasury.
- Behavior of the institution as a whole is the key:
  - responsible: defining objectives, exercising oversight, requiring some transparency
  - never pushed the exchange rate away from equilibrium, always toward it
- Congress exercises oversight and is the right place to exercise accountability.
- But the exchange rate provisions of the 1988 Act must be strengthened.

# Foundations of Accountability

- Acceptance of the institutional division of labor: Treasury exercises authority over exchange rate policy, and Congress holds it to account.
- Standards for assessing whether mandate has been fulfilled
- Sufficient transparency to assess whether standards have been met

# **Congress is the source of authority on exchange rate policy**

The US Constitution gives Congress the power “[t]o coin money, regulate the value thereof, and of foreign coin...”

» Article I, section 8

# **The Exchange Rates and International Economic Coordination Act of 1988**

- Forged in mid-1980s
- Part of Omnibus Trade and Competitiveness Act of 1988
- Established the reporting requirement
- Established manipulation provisions

## **Congressional-Executive tensions are similar in other issue areas**

- Executive agencies report on:
  - Foreign investment
  - Trade policy and negotiations
  - Monetary policy
  - Foreign intelligence
- Exchange rate report not unique in terms of:
  - Balance of expertise between the Congress and the executive
  - Sensitivity of markets
  - Engagement of foreign governments

# Review of 20 Years of Reports

- 3 tests:
  - Narrowest: Are content requirements of the 1988 Act met?
  - Second: Do reports provide the basis for informed oversight?
  - Broadest: Do reports address problems that markets, public, and Congress care about?

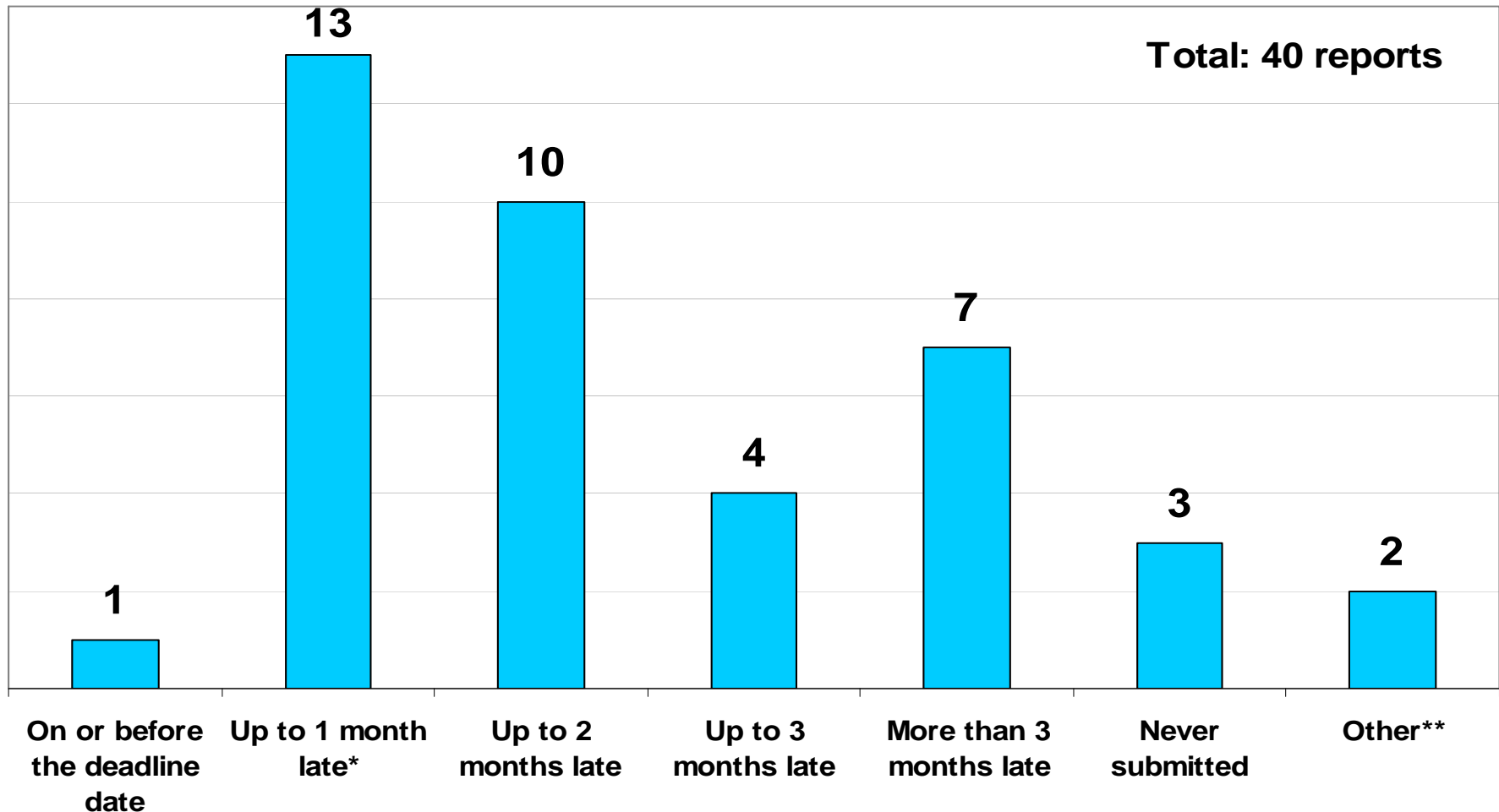
# Review of Reports

- For their treatment of key issues:
  - Findings of manipulation 1988–94
    - Korea
    - Taiwan
    - China
  - Mexican peso crisis, 1994–95
  - Asian financial crisis, 1997–98
  - Japanese yen
  - Europe’s monetary union
  - Fiscal policy
  - China, 2000–2007

# Assessment

- Overall criticisms
  - Lateness
  - Avoidance of some relevant contemporary policy issues
  - Backward-looking and descriptive
- Variation over time
  - Bush I reports a high point
  - Early Bush II reports a low point
- Improvements since 2005
  - More attention to fiscal policy and external indebtedness
  - Analytical appendices
  - Assessment of countries' exchange rates broader
- But:
  - These improvements can be reversed by the next administration.
  - Still fail to find manipulation in a blatant case

# Timing of Submission



\* Including the latest report, released on May 15, 2008.

\*\* Two reports, in October 1999 and April 2000, were joined together, and issued on March 9, 2000.

# Impact of reports

<b>Report</b>	<b>Agency/Organization</b>	<b>Approximate count*</b>
Report on International Economic and Exchange Rate Policies	Treasury Department	<b>35-40</b>
Report on Foreign Exchange Operations	Federal Reserve	<b>60</b>
Semiannual Monetary Policy Report to the Congress <sup>†</sup>	Federal Reserve	<b>220</b>
Federal Reserve Annual Report	Federal Reserve	<b>1,400</b>
World Economic Outlook	International Monetary Fund	<b>6,000</b>
National Trade Estimate Report on Foreign Trade Barriers <sup>‡</sup>	United States Trade Representative	<b>6,500</b>

\* Counts are rough approximations based on search results from **google.scholar** and **Thomson's Social Science Citation Index**; they do not include citations of congressional testimonies on the reports.

<sup>†</sup> Formerly the Humphrey-Hawkins Report to the Congress.

<sup>‡</sup> This report contains estimates for individual countries that are often included as separate bibliographical entries; this somewhat inflates the citation count presented.

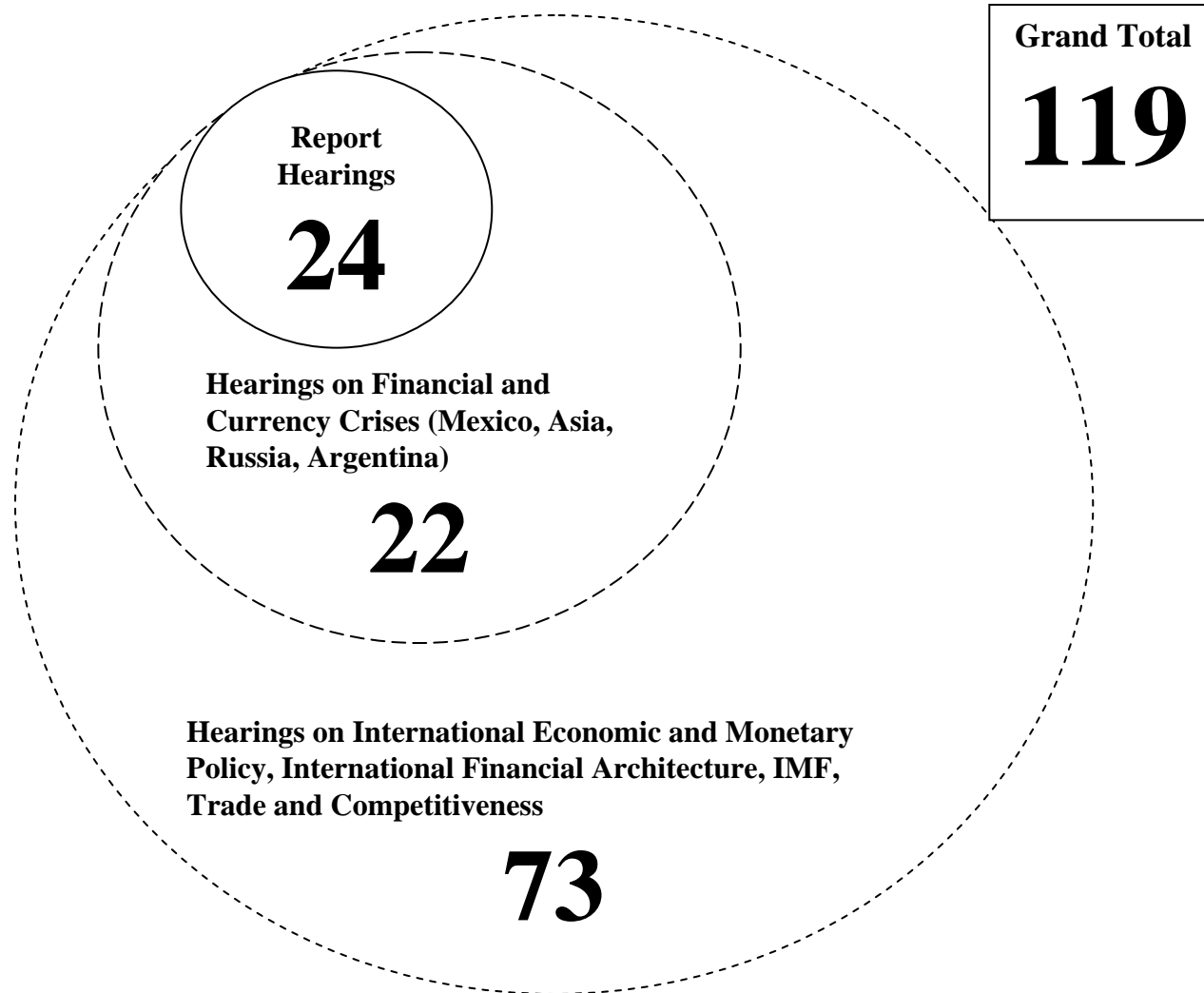
# Comparison to Monetary Policy Reports

- Mildly informative about FOMC thinking
- Good record of meeting its ‘dual mandate’
- Consistently delivered on time
- Despite similar initial resistance to reporting, Fed warmed up to it and embraced the reports as a communication tool
  - “In establishing these hearings [thirty years ago], the Congress proved prescient in anticipating the worldwide trend toward greater transparency and accountability....Over the years, these testimonies and the associated reports have proved as an invaluable vehicle for the Federal Reserve’s communication with the public about monetary policy....”
    - » Ben S. Bernanke, Statement before the Committee on Banking, Housing and Urban Affairs, United States Senate, July 19, 2007

## **Importance of Designation for Manipulation**

- Adheres to procedures of the 1988 act
- Signals seriousness in combating manipulation to domestic public
- Signals the expectation of multilateral cooperation to the international community
- Strengthens Treasury's bargaining position and improves prospects for remediation

# Congressional Hearings (Since 1988)



# Report Hearings

Date	Title	House/Senate	Party Control	Treasury Witness
5/5/1989	First Annual Hearing Exchange Rate Policy	Senate Banking	D	Brady, Mulford
5/12/1989	Currency Manipulation	Senate Finance	D	David C. Mulford
10/31/1989	Treasury Department's Report on Exchange Rate Policy	House Banking	D	David C. Mulford
11/16/1989	Review of the Treasury's Second Annual Report	Senate Banking	D	David C. Mulford
4/19/1990	Treasury's Report on Exchange Rate Policy	Senate Banking	D	David C. Mulford
5/5/1990	Update on Exchange Rate Report	House Banking	D	David C. Mulford
8/14/1990	Treasury's Conduct of International Financial Policy	House Banking	D	David C. Mulford
5/16/1991	Treasury's Report on Exchange Rate Policy	Senate Banking	D	David C. Mulford
11/12/1991	Treasury's Report Exchange Rate Policy: 1991	Senate Banking	D	David C. Mulford
5/12/1992	Treasury Report on Exchange Rates	Senate Banking	D	David C. Mulford
5/25/1993	Treasury's Biannual Report Exchange Rate Policy	Senate Banking	D	Lawrence H. Summers
5/26/1993	Small Business and the International Economy	House Committee	D	Lawrence H. Summers
7/21/1994	Treasury's Spring 1994 Report Exchange Rate Policy	Senate Banking	D	Lawrence H. Summers
5/1/2002	Treasury's Report on Exchange Rate Policy	Senate Banking	D	Paul H. O'Neill
10/1/2003	China's Exchange Rate Regime and Its Effects on the US	Financial Services	R	John B. Taylor
10/30/2003	US-China Relations and China's Role in the Global Economy	Ways and Means	R	John B. Taylor
10/30/2003	Treasury's Report on Exchange Rate Policies	Senate Banking	R	John W. Snow
5/26/2005	Report to the Congress on Exchange Rate Policies	Senate Banking	R	John W. Snow
5/18/2006	International Economic and Exchange Rate Policies	Senate Banking	R	John W. Snow
1/31/2007	Report on Exchange Rate Policy and US-China Strategic	Senate Banking	D	Henry M. Paulson
3/28/2007	U.S.-China Economic Relations	Senate Finance	D	None
5/9/2007	Currency Manipulation and Its Effects on US	Ways and Means	D	Mark Sobel
5/23/2007	U.S. Economic Relations with China	Senate Banking	D	None
6/20/2007	The State of the International Financial Services System	Financial Services	D	Henry M. Paulson

## Assessment of Follow-Up

- Oversight regular when trade issues were prominent
- Democrats followed up more diligently
- Senate Banking Committee more active than House Financial Services Committee
- Congressmen typically reactive rather than proactive; “fire alarm” rather than “police patrol” oversight
- Two issues neglected:
  - Dollar’s value on an effective basis and with respect to the euro
  - Overvaluation

# Recommendations

- Preparing the Reports
- General Objectives
- Manipulation
- Countermeasures
- Congressional Oversight

# Preparing the Report

- Treasury can provide more information on past events and negotiations
- More analysis of relationships between exchange rate and macroeconomic policies, especially fiscal policy
- More attention to cases of overvaluation
- Revise criteria for manipulation
- More punctuality

## General Mandate

- Policy can sometimes take a “hands off” posture toward the exchange rate, but
- Treasury should take an activist posture when:
  - External deficits might not be sustainable
  - Foreign exchange markets become unhinged from economic fundamentals
  - Foreign governments intervene directly or indirectly
- Treasury should (a) assess whether these circumstances apply and (b) recommend or take appropriate action

# Currency Bills of the 110<sup>th</sup> Congress

Main Sponsors	Committee	Key Features
Dodd, Shelby	Senate Banking	"Currency Reform and Financial Markets Access Act of 2007" Abandons intent in finding manipulation; requires WTO XV case if manipulation not remedied
Baucus, Grassley	Senate Finance	"Currency Exchange Rate Oversight Reform Act of 2007" Identifies fundamentally misaligned currencies and currency for "priority action"; applies anti-dumping measures as remedies
Bunning	Senate Finance	"Fair Currency Act of 2007" Same as HR 782
Dorgan, Graham	Senate Finance	S. 571; Proposes a withdrawal of normal trade relations treatment from China
Rockefeller	Senate Finance	"Strengthening America's Trade Laws Act" Treats exchange rate manipulation as countervailable subsidy; manipulator may have a status of a market economy
Stabenow	Senate Finance	"Japan Currency Manipulation Act" Secretary to initiate negotiations with Japan and in G-7
Stabenow	Senate Finance	"Trade Prosecutor Act" Establishes a position of trade enforcement officer with USTR, manipulation qualifies as priority trade practice
Camp, Jones	Ways and Means	Same as S 445
Davis, English	Ways and Means	"Nonmarket Economy Trade Remedy Act of 2007" Makes nonmarket economies acceptable for countervailing duty cases
English	Ways and Means	"Currency Harmonization Initiative Through Neutralizing Action Act of 2005" Applies manipulation-neutralizing tariffs
Kaptur	Ways and Means	HR. 1958; Same as S571
Ryan, Hunter	Ways and Means	"Fair Currency Act of 2007" Inclusion of "fundamental misalignment" definition, which is to become countervailable under CVD law
Ryan, Hunter	Ways and Means	"Currency Reform for Fair Trade Act of 2007" Modifies manipulation concept as "fundamental misalignment", which receives priority action if certain criteria satisfied, including intervention; is countervailable, and is a basis in calculating anti-dumping duties
Spratt, Myrick	Ways and Means	HR. 1002; Imposes duty rate of 27.5 percent on Chinese imports
Tancredo	Ways and Means	HR. 571; 5% additional tariffs imposed on exports of any nonmarket economies
Knollenberg (R-M)	Ways and Means	"Japan Currency Manipulation Act"; Same as S. 1021

# Manipulation

New legislation should provide for the finding of manipulation in one of two ways:

(1) Foreign exchange intervention is:

- Large in scale
- Protracted over two to three years
- Consistently in one direction
- Perpetuates or accentuates a significant current account imbalance

(2) When, in the presence of a fundamental misalignment, one or more of the following (IMF criteria) is found:

- An unsustainable level of official borrowing or lending
- Restrictions or incentives on current transactions or capital flows
- Abnormal dis/encouragement to capital flows
- Large external vulnerabilities arising from private capital flows

# Countermeasures

- Currency undervaluation is similar to tax on imports and a subsidy to exports
- Trade measures that compensate for the distortion can in principle enhance economic efficiency and fairness
- But, such trade measures should be:
  - Applied only in cases of undervaluation caused by manipulation
  - Proportionate
  - Removed when manipulation ceases
  - Removed if found inconsistent with WTO

## Reinforcement of IMF

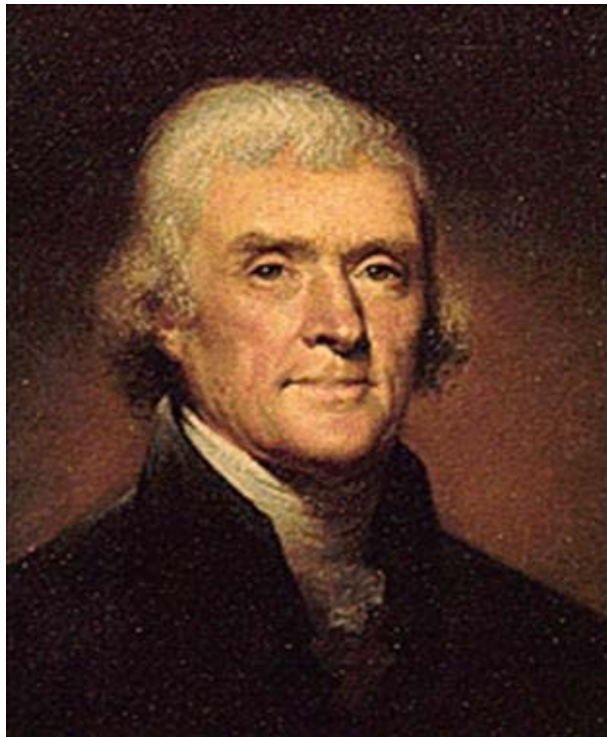
Unilateral US action can be consistent with multilateral rules and norms in two ways:

- 1) Provide national means of enforcement;
- 2) Can be traded off for tougher enforcement at the multilateral level, as Section 301 was (partly) traded off for WTO dispute settlement.

# **Congressional oversight**

- (1) Separation of trade and finance problematic
- (2) Making the linkage is essential
- (3) Regularize multi-committee participation in oversight
- (4) Leadership should be proactive

## Thomas Jefferson (“Republican”)



“I know no safe depository of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education.”

Letter to William Charles Jarvis, 28 September 1820, in P.L. Ford (ed.) *Writings of Thomas Jefferson* (1899) vol. 10

Source: The Oxford Dictionary of Quotations

## Alexander Hamilton (“Federalist”)



Advocated strong Executive powers but offered thorough reports to Congress:

- First Report on the Public Credit; January 14, 1790
- Second Report on Public Credit: Report on a National Bank; December 14, 1790
- Report on the Establishment of a Mint; January 28, 1791
- Report on Manufactures; December 5, 1791