

CIGI Papers No. 224 – July 2019

Trump Trade Policy, Exchange Rate Surveillance and the IMF Back to the Future?

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About the Author

James A. Haley is a CIGI senior fellow and former executive director for the Canadian-led constituency at the International Monetary Fund (IMF) in Washington, DC. He served as Canada's executive director to the Inter-American Development Bank in Washington, DC, from 2012 to 2015. Prior to this appointment, he held a number of senior positions in the Canadian Treasury (Department of Finance) and the Bank of Canada. He has represented Canada at meetings of the Working Party 3 and Economic Policy Committee of the Organization of Economic Cooperation and Development, co-chaired the G20 working group on re-balancing the global economy, and served as Canadian representative on numerous international working groups. He has lectured on macroeconomics, international finance and international financial institutions at the McCourt School of Public Policy, Georgetown University and the Norman Patterson School of International Affairs, Carleton University. His published work focuses on international financial issues, the IMF and sovereign debt restructuring.

About Global Economy

Addressing the need for sustainable and balanced economic growth, the global economy is a central area of Centre for International Governance Innovation (CIGI) expertise. The Global Economy initiative examines macroeconomic regulation (such as fiscal, monetary, financial and exchange rate policies), trade policy and productivity and innovation policies, including governance around the digital economy (such as big data and artificial intelligence). We live in an increasingly interdependent world, where rapid change in one nation's economic system and governance policies may affect many nations. CIGI believes improved governance of the global economy can increase prosperity for all humankind.

Executive Summary

This paper discusses the nexus between the Donald Trump administration's trade policy and International Monetary Fund (IMF) exchange rate surveillance. It reviews the evolution of IMF surveillance and the possible implications of incorporating currency manipulation clauses into bilateral trade agreements. Such clauses constitute a key US trade negotiation objective. While they may reflect genuine concern over practices to thwart international adjustment, they could erode the effectiveness of the IMF at a time of transition and resulting tension in the global economy. Managing this tension calls for a cooperative approach to the issue of adjustment, one consistent with the fundamental mandate of the IMF. An approach based on indicators of reserve adequacy is proposed. Such a framework was briefly considered and dismissed almost 50 years ago, which was likewise a period of tension in trade and global monetary affairs. Prospects for success today are equally dim because cooperative measures to assuage adjustment challenges would require repudiation of the view that exchange rate surveillance is about bilateral trade balances and abandonment of the zero-sum game approach to international arrangements on which Trump administration trade actions are based.

Introduction

The mercantilist proposition that trade deficits are intrinsically “bad” while surpluses are “good” was a key theme of Trump's 2016 presidential campaign. On the campaign trail, Trump blamed persistent US trade deficits on blatant exchange rate manipulation by which others took advantage of the United States through “badly negotiated” trade agreements. These messages remain presidential talking points.¹ Yet, under his administration, the US Treasury has issued five consecutive semi-annual reports on macroeconomic and foreign

1 For example, on July 3, 2019, Trump tweeted: “China and Europe playing big currency manipulation game and pumping money into their system in order to compete with USA.” Donald J. Trump, Twitter post, July 3, 2019, 7:21 a.m., <https://twitter.com/realdonaldtrump/status/1146423819906748416?lang=en>.

exchange practices without labelling China a currency manipulator. Instead, the White House adopted a different approach to trade deficits.

In 2018, Washington fired the opening salvo in a possible global trade war by imposing tariffs on Chinese goods. Under the pretext of national security, tariffs were also levied on the steel and aluminum exports of several countries, including those of North Atlantic Treaty Organization members. Together with repeated presidential threats to withdraw from the North American Free Trade Agreement (NAFTA), overtures to Germany to negotiate a possible bilateral trade agreement and a refusal to nominate candidates to the World Trade Organization (WTO) dispute settlement appellate body, these tariffs underscore the US administration's disruptive approach to trade relations.²

These actions are deeply worrying. They reflect a zero-sum approach to trade in which one player's gain is another player's loss. In contrast, the obligations and safeguards of the rules-based trading system erected over the past seven decades create a positive-sum game that benefits all countries that play by the rules. In this respect, while the decision to withhold nominations to the WTO appellate body is portrayed as a principled defence of sovereign rights in the face of tribunal rulings *ultra vires* to agreed obligations, US recalcitrance could paralyze the dispute settlement process that upholds the safeguards that membership provides. With the rules-based trading system weakened, the United States would be free to exploit its size to secure more advantageous trade deals.³ Trade flows could be reduced, however, with the attendant loss of benefits. Recent US actions might thus

2 In the end, NAFTA was ultimately renegotiated with only modest changes, while Germany orchestrates its trade policy through the European Union and could not take up the president's invitation. At the time of writing, negotiations to end US-China trade actions are ongoing, with a truce restoring the status quo ante a possibility. The outlook regarding the WTO appellate body is unclear, although it is difficult to see how it can be resolved without a unilateral US back down. For a discussion of the potential threats to the rules-based trading system, see Payosova, Hufbauer and Schott (2018a and 2018b).

3 One reviewer rightly notes that some administration officials defend these tactics as a way to combat Chinese trade and industrial practices that pose a threat to the multilateral trading system; they argue that the time for conventional negotiations and tactics has passed. While this may be the rationale, it is difficult to reconcile it with the imposition of, or threats to, impose unrelated tariffs on long-standing allies that are the strongest supporters of the rules-based system. In any event, it is akin to the widely cited, but possibly apocryphal, Vietnam War aphorism: “we have to destroy the town in order to save it.”

enable it to obtain a bigger piece of a shrinking pie; in the process, everyone would suffer.

As disruptive as recent US trade actions are, there is another threat to the rules-based international architecture. This is the effect of currency manipulation clauses inserted into bilateral (plurilateral) trade agreements. These clauses predate the Trump administration. And while they are portrayed as consistent with existing international obligations, these measures could weaken the legitimacy and effectiveness of the IMF at a time of heightened risks to the global economy.

This is not to imply that the status quo is without faults. Existing arrangements can be improved. But in seeking to address problems with exchange rate surveillance, the risk of unintended consequences of purported “fixes” must be evaluated. With the US trade deficit currently (July 2019) increasing, the president’s trade policies are failing, even when assessed on his own metric.⁴ These deficits are attributable to administration policies, in particular tax and spending measures that have led to large full employment fiscal deficits. Trade imbalances and charges of exchange rate manipulation will nevertheless figure prominently in the US 2020 general election, as the administration will be motivated to intensify its efforts to identify and punish those it deems guilty of unfair practices. Trade tensions and heightened risks to the global economy are likely.

This paper assesses these risks and offers an alternative approach to defusing trade tensions likely to come from widening US trade deficits. It proceeds as follows. The next section reviews exchange rate surveillance and the IMF’s role in supporting stable exchange rates under the Bretton Woods system, and stable exchange rate arrangements in the flexible exchange rate era that followed the collapse of Bretton Woods. Perennial complaints with respect to surveillance, which account for more recent efforts to introduce currency manipulation clauses in bilateral trade arrangements, are then discussed. This is followed by a review of the potential risks associated with moving exchange rate surveillance from a multilateral body to a bilateral setting. Given these risks, an alternative approach to the issue of exchange rates, one that shifts focus

from exchange rates to adjustment and reserve accumulation, is discussed in the penultimate section. This approach is better aligned with the underlying rationale for the IMF and does not engender the potential threats to the rules-based system that bilateral currency manipulation clauses pose. The final section concludes the paper with observations on challenges that are likely to arise in the coming months and suggestions on how the rules-based system can best be supported in the face of these threats.

Exchange Rate Surveillance

US efforts to strengthen exchange rate surveillance date back to World War II and discussions on a rules-based international economic and financial system. These discussions focused on restoring global trade — a key US objective at the Bretton Woods conference that created the IMF and the World Bank in July 1944, even as global war raged. At the time, it was feared that the global economy would stagnate with the end of hostilities, as defence spending was cut and armies demobilized. The concern was a return to the economic chaos of the 1930s, when trade collapsed under the weight of prohibitive tariff barriers and beggar-thy-neighbour policies as countries abandoned the dysfunctional interwar gold standard at greatly depreciated exchange rates (Bernstein 1984).

The collapse of international trade was thought to have propagated global stagnation in the Great Depression; reducing tariffs was therefore an important priority. Trade liberalization would not be possible, however, if countries were free to use monetary protectionism — the conscious undervaluation of currencies — to offset the loss of tariff protection. No country would agree to coordinate tariff reductions if other countries could regain competitive advantage through a beggar-thy-neighbour devaluation. All countries might want freer trade, but absent some means to monitor exchange rates and enforce commitments, trade liberalization would be stymied.

⁴ The US trade deficit in goods, the measure targeted by Trump, was US\$891 billion in March 2019. See Tankersley and Swanson (2019).

The IMF resolved this coordination failure.⁵ The solution was a quasi-gold standard: IMF members fixed their currencies to the US dollar, which in turn was pegged to gold. Countries also agreed to limit the fluctuation of their currencies around their pegs, which could only be changed in consultation with the IMF and in response to “fundamental disequilibrium.” The resulting exchange rate system facilitated a progressive phased reduction of tariff levels and resuscitated global trade.

Bretton Woods was the operating system for trade liberalization and, for the most part, the program ran smoothly. However, two “bugs” were written into the trade liberalization software. The first bug was unintentional. While the IMF was designed to prevent currency practices that secured unfair competitive advantage, its efforts to police members’ commitment to eschew competitive exchange rate devaluations have long been criticized by some as asymmetric and by others as ineffective.⁶ Because the IMF can withhold resources from a member found to be in violation of these undertakings, exchange rate adjustment has been a condition of access to Fund resources. In theory, this condition applies to all IMF members. In practice, the prohibition on the use of resources to countries pursuing inappropriate exchange rate policies has been confined to countries with contingent access to private capital markets, not to large advanced economies that have not been required to call on the IMF. The result has been pointed accusations that the system is asymmetric, with one set of rules for smaller countries and another set for larger members. Meanwhile, those advanced countries — in particular, the United States — have been sometimes vocal

critics of IMF exchange rate supervision, calling for reforms to enhance its effectiveness.

The second “bug” in the Bretton Woods trade liberalization software was the conscious decision to make the US dollar the unit of account for the global monetary system. Provided the dollar’s gold peg was viewed as credible, the system allowed the United States to shift the burden of external adjustment to others. Other countries derided this feature of the system as “exorbitant privilege.”⁷ Yet, the dollar’s unique role also entailed a potential curse: because the US dollar was the global unit of account, other countries could intervene to peg their currencies at an undervalued rate. In the Bretton Woods era of fixed but adjustable exchange rates, the requirement to consult with the IMF prior to adjusting par values likely limited competitive devaluations and enhanced stability. With the move toward flexible exchange rates post-1973, however, it became more difficult to limit such intervention. For much of the past five decades, US international financial policy has largely sought to preserve the blessings of exorbitant privilege while managing the unit of account curse.

Despite these glitches in the system, complaints of competitive devaluations and enforcement were rare under Bretton Woods. Two factors explain this outcome. The first factor was the commitment to full employment that the Bretton Woods system was constructed to promote, which led governments to pursue expansionary policies and overvalued currencies. The second factor was the fact that exchange rates that were meant to be fixed, but adjustable, quickly became ossified as governments avoided needed devaluations, fearing the political consequences of the resulting decline in purchasing power. In this respect, incipient balance-of-payments crises were typically preceded by the steady loss of reserves until the commitment to the fixed peg was no longer credible. The dramatic devaluation of the currency that inevitably followed was at that point unavoidable. If, in contrast, countries found the prevailing exchange rate peg inconsistent with domestic stabilization objectives, they would more

5 As Article I of the Articles of Agreement made explicit, the purposes of the IMF include: “(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy. (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.”

6 Similarly, since undervalued currencies may constitute subsidies to exports, a country that fails to play by the rules could be subject to countervail subsidies under trade rules. Article XV of the General Agreement on Tariffs and Trade, the precursor to the WTO, commits contracting parties to avoid exchange rate measures that frustrate the intent of the trade agreement and from engaging in trade actions that frustrate the intent of the IMF’s Articles of Agreement, including the Article IV prohibition of competitive exchange rate devaluations. No country has been thus penalized. Perhaps this is because a body entrusted with trade liberalization is loath to condone tariffs that could trigger a tit-for-tat retaliation.

7 In 1968, former US Treasury Secretary John Connally starkly put this proposition to his European counterparts. “It may be our dollar,” he said, “but it is your problem.” See Sobel (2019) for a reference to and discussion of the context for this “indestructible curse.”

likely abandon the fixed regime and float their exchange rates, as Canada did in September 1950.⁸

Canadian experience presaged the collapse of the Bretton Woods system in the early 1970s. Through the 1960s, the foundations of the system were steadily eroded by two factors. The first was a by-product of its success: postwar global growth ensured that the United States was no longer the only important country in the global economy and the US dollar the only important key convertible currency.⁹ The second factor that undermined the Bretton Woods system was US fiscal policies that were fundamentally inconsistent with the US dollar's role as anchor currency. At the time, the United States was engaged in an ideological "Cold" War with the Soviet Union, a so-called "hot" war in Vietnam and a "war on poverty" at home. The fiscal deficits that resulted from fighting on three fronts increased external claims on the US gold reserves backing the currency and led to a loss of confidence in the system. The status quo was not sustainable; acknowledgement of that fact came in August 1971 when President Richard Nixon suspended the dollar's convertibility to gold. Subsequent efforts to revive the system based on new parities were unsuccessful, and by March 1973, all major currencies were floating.

The shift to flexible exchange rates freed central banks from the nominal anchor that had kept inflation in check. And when the first Organization of the Petroleum Exporting Countries oil shock in late-1973 led to higher oil prices and an adverse supply shock, inflation accelerated as monetary authorities attempted to maintain full employment. Wide swings in nominal exchange rates and exchange rate volatility ensued, which generated large movements in competitiveness and growing trade tensions. It was at this point that concerns were raised regarding the use of monetary policy to manipulate exchange rates to gain an unfair competitive advantage. The threat was akin to the beggar-thy-neighbour devaluations of the 1930s and the collapse of trade that followed.

8 The Canadian dollar was floated in response to capital inflows that put intense upward pressure on the Canadian dollar.

9 As one reviewer puts it, the dollar-based system would not have been viable in the 1970s even if the United States had been running consistent current account surpluses.

Surveillance under Floating Rates

Against this background, demands were soon made for IMF monitoring (or "surveillance") of members' policies to ensure adherence to the obligations of Article IV, specifically the prohibition of exchange rate manipulation to gain an unfair competitive advantage. Changes were indisputably needed. The par value system that supported fixed exchange rates was gone; in its place, principles to guide IMF surveillance were adopted in 1978 amendments to the IMF Articles of Agreement.¹⁰

The amendments obliged members to "take into account" the interests of others when intervening in exchange markets, in particular when engaging in "protracted large-scale intervention in one direction" and "excessive" reserve accumulation. In this respect, IMF exchange rate surveillance was intended to identify policy inconsistencies that could result in currency misalignments and pose a risk of financial instability that could spill over to other members. However, while these principles could be used to trigger consultations, the terms "protracted" and "excessive" were not defined. Nor was the IMF authorized to take punitive measures against a member guilty of exchange rate manipulation.¹¹ The 1978 amendments also did not oblige members to heed IMF advice.¹² Of course, where a member is drawing on its resources, the IMF has traction

10 Surveillance was not an issue prior to the collapse of the Bretton Woods exchange rate system in 1973 since members' commitments to the rules of the game were monitored by their adherence to pre-announced exchange rate pegs and the requirement that fixed pegs could only be changed in response to conditions of "fundamental disequilibrium."

11 It is sometimes presumed that "protracted large-scale intervention in one direction" is proscribed by the IMF's Principles of Fund Surveillance over Exchange Policies. This is not so. The Principles state that such intervention is only the basis for discussions between the Fund and the member. In any event, while the Articles gives the Fund the right to declare a country ineligible to borrow and to take steps up to and including expulsion, the executive board has been reluctant to apply that pressure, especially on China. Similarly, disputes over exchange rates can be referred to the WTO for a ruling on the legitimacy of "protective" tariffs against Chinese imports, but no such case has ever been successfully pursued.

12 The IMF does not make programs conditional on the adoption of an explicit exchange rate regime. In this respect, the 1978 amendments acknowledged the right of members to adopt the exchange rate regime of their choosing, subject to consultation with the IMF.

through the policy commitments, or conditionality, on which access to resources is made.¹³

This unsatisfactory state of affairs persisted for almost three decades. It might well have continued had the emergence of large external imbalances prior to the global financial crisis not led to concerns of a possible disorderly unwinding. At the time, large China-US imbalances were widely attributed to Chinese intervention that prevented an appreciation of the Chinese currency. The issue was how to promote an orderly unwinding of external imbalances in an environment in which many countries allowed their currencies to float freely, but some countries fixed their currencies to the dollar or operated heavily managed exchange rate regimes.¹⁴

For the United States, the dilemma was that the depreciation needed to facilitate external adjustment was prevented as other countries fixed their currencies to the dollar.¹⁵ While countries with large foreign exchange reserves worried about the expected capital losses from dollar depreciation, they also feared possible deflationary consequences of large revaluations. The result was a precarious outcome in which some countries accumulated very large foreign exchange reserves as the US net foreign asset

position steadily deteriorated — a situation dubbed a “financial balance of terror” (Summers 2004).¹⁶

The concern was that a sudden unwinding of these imbalances could trigger economic disruption. And while efforts to secure co-ordinated policy actions to unwind these imbalances were unsuccessful, important changes were made to IMF surveillance as a result of them. In particular, proposals advanced by the US Treasury sought to sharpen the IMF’s exchange rate surveillance principles by defining “protracted,” “large scale” and “excessive.”¹⁷ Greater precision was required since countries will not voluntarily abide by IMF admonitions on exchange rates unless the “ground rules” are clear. Debate on the US proposals revealed such definitions would have to be broadly acceptable to all members, as befits the consensual nature of the institution.

Another critique of IMF surveillance was that it had become too focused on domestic economic developments and policies, especially fiscal policy and structural, demographic and longer-term factors. The pendulum had swung too far from IMF core competencies and its underlying — monetary — mandate. A refocusing of surveillance on external factors was long overdue.

Under the US proposals, this refocusing would be achieved by the IMF providing a consistency check on a member’s exchange rate and domestic policies, and the obligations of membership in the international financial system. IMF surveillance could thus evaluate whether alternative exchange rate arrangements or regimes might be more appropriate and provide advice (or encouragement, if appropriate) regarding exit from unsustainable exchange rate regimes. Meanwhile, the Special

13 This policy leverage accounts for long-standing concerns that there are two sets of rules — one for advanced economies unlikely to draw on IMF resources, and a second set for emerging and developing countries more likely to call on the IMF for support. As discussed more fully below, this asymmetry is the basis of critiques that the IMF lacks legitimacy; in particular, where it is viewed as propagating the exorbitant privilege through exchange rate advice.

14 At the time, China was the most visible example of the latter. Its relative importance as a surplus country has since declined as German surpluses and those of oil exporters increased.

15 While the law of weighted averages suggests that countries with flexible exchange rates will bear a disproportionate burden of exchange rate adjustment, such partial analysis can be misleading. The full effects of exchange rate adjustment must be considered in the context of a general equilibrium model that allows for interaction effects between the various countries.

16 Not everyone viewed the steady deterioration in the US net foreign asset position in the same apocalyptic terms. The *Economic Report of the President* (Council of Economic Advisors 2006) highlighted record US capital account *surpluses*, not the current account *deficits*. Similarly, some academics argued that the United States had to run current account deficits to supply the financial assets that other countries require to support financial intermediation and achieve an efficient international diversification of risks. While such arguments may have some merit, the increase in assets cannot be unbounded. Indeed, there are possible parallels with the Triffin dilemma in the final days of the Bretton Woods system. The difference now is that the United States is supplying assets to facilitate the expansion of asset trade (capital account), not just the liquidity needed to support the growing global trade flows (current account) of the 1960s. Just as the Triffin dilemma eventually undermined confidence in the Bretton Woods system, continued deterioration in the US net foreign asset position could eventually erode confidence in the role of the dollar as the international reserve asset and vehicle currency.

17 See Adams (2006).

Consultation Mechanism, or formal discussions on the appropriateness of a member's exchange rate, would be "de-stigmatized" by providing for consultations whenever the IMF's annual reviews of members' policies raise serious questions about the sustainability of exchange rate policies or the compatibility of exchange rate arrangements with the Fund's principles.¹⁸

Multilateral Surveillance Reform

Perhaps the recommendation with the greatest potential to fundamentally change exchange rate surveillance was a proposal to draw on quantitative efforts at exchange rate determination. Based on this empirical work, the IMF would publish a regular report that would facilitate the identification of exchange rate policies that damage other members or pose a risk to the international financial system. Underlying the proposal was a simple truth: if the IMF is to be more proactive in exchange rate surveillance, it needs an analytical framework on which members agree. However, there is a plethora of models and conceptual approaches to defining a unique equilibrium level of the exchange rate; no one empirical model is likely to enjoy universal support. And the more methodological approaches and number of empirical techniques employed, the greater the likelihood of ambiguity with respect to their findings — some will signal overvaluation, others undervaluation. Cases in which all indicators transmit the same signal would be quite rare and would likely be the most egregious cases of misalignment.¹⁹

Notwithstanding these challenges, the proposal at least focused attention on the crucial role of exchange rates in fostering international adjustment, consistent with the IMF's core mandate. In this respect, it offered a possible approach to strengthening IMF exchange rate

surveillance.²⁰ The proposal was notable because it implicitly focused attention on the multilateral dimension of the problem. Exchange rates cannot be explained on the basis of bilateral trade considerations alone, especially in the context of capital account considerations regarding the accumulation of large stocks of claims. It is thus noteworthy that pre-crisis debates on exchange rate surveillance culminated in the 2007 Surveillance Decision, which added financial stability to the existing guidelines for surveillance. In announcing the decision, IMF Managing Director Rodrigo De Rato noted:

To three existing principles relating to exchange rate manipulation pursued for certain purposes, and to when and how it is desirable to intervene in the foreign exchange rate markets, the decision adds a fourth principle: a member should avoid exchange rate policies that result in external instability. Reflecting the period when [the 1977 decision] was drawn up, it focused on potential exchange rate manipulation undertaken for balance of payment reasons and on short term exchange rate volatility. By contrast, the most prevalent exchange rate related problems since then have been the maintenance, for domestic reasons, of overvalued or undervalued exchange rate pegs and, more recently, capital account vulnerabilities. (IMF 2007)

As De Rato's comments suggest, Lawrence Summers' financial balance of terror was a key driver of the 2007 decision. In the end, concerns of financial crisis were validated. But the source of the crisis that subsequently erupted was not the sudden and disruptive unwinding of external imbalances. It was, rather, risks originating in the

18 Whatever its merits, the proposal that the Fund not "accept uncritically a country's choice of exchange rate regime" ignored the fact that IMF missions frequently engage in lengthy — often heated — discussions with national authorities over the feasibility or desirability of exchange rate arrangements. These discussions and implicit policy advice are not typically part of the formal negotiations, however, because the IMF lacks jurisdiction to force a member to change its exchange rate regime. In this respect, "going public" on its exchange rate advice, and then having that advice ignored, would undermine the Fund's credibility.

19 By way of example, at the time the proposal was made, it was unclear that the prevailing "Chinese currency controversy" would have been included in this category. See Cheung, Chinn and Fujii (2005).

20 The proposal subsequently influenced the development of the IMF External Sector Report, which has been produced annually since 2012, and is a key part of the IMF's surveillance. As the IMF notes, these reports integrate "multilateral and country-specific perspectives, while ensuring individual economy assessments add up to a coherent, multilaterally consistent view. Specifically, staff assessments draw on estimates from the External Balance Assessment approach as well as country-specific evidence and judgment, while acknowledging the uncertainties inherent in such assessments." See www.imf.org/en/Publications/SPROLLS/External-Sector-Reports. The External Balance Assessment, meanwhile, assesses the appropriateness of exchange rates, taking account of the effects of policies and potential policy distortions. It seeks to identify exchange rate levels that would be consistent with country fundamental characteristics and desirable settings of relevant policies.

banking systems of key economies at the core of the global economy, not reserve accumulation by countries at the periphery. The global financial crisis nevertheless influenced the next step in the evolution of IMF exchange rate surveillance.

The trauma of the crisis animated efforts to mitigate the systemic threats that arise in a highly integrated world economy. These efforts included measures to strengthen the legal framework for IMF surveillance, culminating in approval of the Integrated Surveillance Decision in 2012. The decision broadens the focus of Fund surveillance to economic and financial stability both at the individual country and global levels by expanding the scope of Article IV consultations to encompass multilateral surveillance, allowing for a “more comprehensive, integrated, and consistent spillover analysis” (IMF 2013). Of particular importance in the context of exchange rates, the Integrated Surveillance Decision promotes a more balanced treatment of domestic and exchange rate policies by adding guidance on the conduct of member countries’ domestic policies while maintaining the existing principles for exchange rate policies.

Exchange Rates and Trade Agreements: Going It Alone

The 2007 Surveillance Decision and the Integrated Surveillance Decision are important advances in the quasi-legal foundations for IMF jurisdiction over exchange rate policies that threaten global financial and economic stability by thwarting international adjustment. A fundamental challenge of enforcement remains, however. Although the Integrated Surveillance Decision encourages countries to be mindful of the impact of their policies on global stability, members have no obligation to change policies as long as they promote their own stability. Moreover, while “large-scale intervention in one direction in the exchange market” is prohibited and “large and prolonged” current account imbalances are a reason for review of exchange rates, such triggers do not determine if a currency is misaligned because of deliberate policy actions designed to

gain an unfair competitive advantage. Frustration with the process for enforcing obligations at the multilateral level has led the United States to tie exchange rate surveillance to trade agreements in which the United States has more leverage and can directly exercise its power.

This initiative predates the current administration. It has precursors in the 1988 Omnibus Trade and Competitiveness Act, with its “super 301” clause.²¹ More recently, in providing its 2014-2015 Trade Promotion Authority (TPA) for the Trans-Pacific Partnership (TPP), Congress stipulated that “avoidance of manipulating exchange rates” must be a principle negotiating objective in future trade agreements (Bergsten 2018). And while the administration of Barack Obama subsequently negotiated a side agreement to the TPP, US withdrawal from that agreement meant that adoption of it had to wait until the 2018 revision of NAFTA, the Canada-United States-Mexico Agreement (CUSMA). The Trump administration has since declared that all future US trade agreements will contain such clauses.

The currency manipulation chapter of CUSMA is an expanded version of the draft TPP side agreement (see Annex). In addition to sharing similar undertakings with respect to broad objectives, exchange rate practices, transparency and reporting, and consultations, the revised 2018 NAFTA agreement (CUSMA) defines the scope of exchange rate commitments and provides for bilateral consultations and a dispute settlement process. These provisions are summarized in Table 1.

Advocates argue that currency manipulation clauses are necessary given the IMF’s failure to effectively police exchange rates and prevent currency practices that constitute unfair trade practices.²² They contend the adoption of such clauses would prevent exchange rate practices that thwart effective exchange rate adjustment (Johnson 2015). This benign outcome would indeed limit the accretion of large external imbalances that threaten international financial stability.

Unfortunately, enforcing these provisions is likely to prove contentious. Exchange rate surveillance is a complex issue — one that does not admit to

21 See James Boughton (2001) for a discussion of how the IMF reacted to the legislation by holding a special surveillance review of Korea.

22 See Bergsten (2018).

Table 1: Exchange Rate Chapter of CUSMA (2018)

General Provision	Recognizes importance of market-determined exchange rates and macroeconomic stability; share objective of pursuing policies to strengthen economic fundamentals, foster growth and transparency, and avoid unsustainable imbalances.
Scope	Excludes regulatory or supervisory actions, monetary and credit policy and related conduct of exchange rate, or fiscal or monetary policy, from Chapter provisions.
Exchange Rate Practices	Specifies that parties accept IMF obligations to avoid exchange rate manipulation to prevent effective balance-of-payment adjustments or gain competitive advantage; agree to promote market-determined exchange rates, eschew competitive devaluation and strengthen economic fundamentals in furtherance of exchange rate stability.
Transparency and Reporting	Commits parties to timely publication of data on foreign exchange reserves, intervention in spot and forward markets, quarterly balance-of-payments portfolio capital flows, and quarterly exports and imports. Agree to publish IMF Article IV reports and confirm participation in IMF data collection exercise.
Macroeconomic Committee	Establishes Macroeconomic Committee (to meet annually) to monitor implementation of the Chapter, macroeconomic and exchange rate policies, data disclosure and possible amendments to the chapter (excluding scope), which can be made by consensus decision.
Principle Representative Consultations	Creates process for bilateral consultations with respect to possible derogation of obligations under Exchange Rate Practices and Transparency and Reporting. Absent a mutually satisfactory resolution, the IMF may be requested to conduct “rigorous surveillance” or initiate a formal consultation.
Disputes Settlement	Restricts recourse to Dispute Settlement Mechanism to violations of obligations under Transparency and Reporting that have not been resolved through Principle Representative Consultations.

Source: Author (from CUSMA).

a simple approach. But this complexity has not prevented simple proposals, including a three-step test based on whether a country had a current surplus over a six-month period, the country added to foreign exchange reserves during this period and whether it has more than sufficient foreign exchange reserves (greater than the amount needed to cover three months of normal imports).²³ Countries that fail the test would have their tariff benefits revoked for at least one year.

Several problems plague this approach (Solis 2015). First, it ignores existing IMF jurisprudence that, for currency practices to be a violation of members’ obligations, the objective behind them must be to prevent effective balance-of-payment adjustments. In short, the “determination of

intent is required” for a breach of Article IV.²⁴ Proponents of currency manipulation clauses cite the difficulty of establishing intent as the principal advantage of simple tests that substitute objective criteria for assessments of underlying objectives. But this creates another problem.

Second, simple tests are not sufficiently calibrated to appropriately address the complexities of exchange rate determination. This can be viewed in the context of *rules* versus *discretion*. For example, existing IMF prohibitions on currency practices are based on protracted and large-scale interventions of countries recording sizable current account imbalances for extended periods. However, what constitutes protracted, large-

²³ The American Automobile Policy Council (AAPC) is the leading advocate of this approach. See AAPC (2014).

²⁴ See Hagan (2006, 15), specifically: “The fact that the measure has the effect of preventing adjustment is not sufficient – the use of the phrase ‘in order to’ means that a determination of intent is required. This does not mean, however, that the Fund is required to accept the member’s own representation of its motives.”

scale and sizable can reasonably be expected to differ in different circumstances. In other words, these conditions require an element of discretion that a rules-based approach lacks.

Third, simple rules are subject to a basic criticism that they ignore critical analytical considerations — that the trade-off for simplicity is analytical rigour. Consider the three months of imports rule of thumb on reserve accumulation (or, equally, some metric based on short-term foreign debt outstanding). Such a rule does not allow for intergenerational considerations regarding the long-term management of non-renewable resources. In addition, simple rules are unlikely to capture the range of factors driving exchange rates, trade balances and foreign exchange reserve management. IMF work on reserve adequacy, for example, identifies the types of shocks that countries hedge against (trade, capital account reversals, growth) and shows that reserve adequacy is a function of access to alternative sources of contingency finance (IMF 2011). Moreover, the IMF study notes that countries can maintain reserves for several different legitimate reasons (liquidity, precautionary and intertemporal optimization motives). No simple rule will suffice.

These shortcomings underscore the fact that exchange rates are a statistic, in the sense that they summarize myriad information on current and expected future monetary and fiscal policy, as well as policies affecting long-term real growth. In contrast to the mercantilist perspective that motivates US trade policy today, which attributes US trade deficits to exchange rate manipulation and unfavourable trade deals, external imbalances reflect underlying savings and investment in the economy while bilateral exchange rates are determined by the interplay of global factors. As Kemal Dervis (2015) framed the issue at the time of the 2014-2015 TPA: “The situation is complicated by the multitude of mechanisms whereby treasuries and central banks can drive down their exchange rates to gain a competitive trade advantage.... In short, for ‘policies affecting the exchange rate’ to become part of trade agreements, monetary and fiscal policies would have to become part of trade agreements. In that case, there would be no trade agreements at all.”

There is a *zugzwang*: either currency manipulation clauses specify simplistic rules that ignore the underlying economics of exchange rates and current account determination, or they incorporate

the myriad considerations and the complexities that go with them, recreating the uncertainties and ambiguities that bedevil IMF exchange rate surveillance. To smaller countries, the former approach may be tantamount to the giving the United States unilateral power to determine whether other countries are manipulating exchange rates and when to impose penalties. Such concerns would reflect the exorbitant privilege of the US dollar that allows the United States to set monetary conditions appropriate to the United States, while other countries confront the more challenging task of balancing domestic objectives (full employment and price stability) with external objectives.

The currency manipulation chapter in CUSMA reflects the latter approach. It is largely an expression of good faith, and it is unlikely that it will be used with cause. Nevertheless, given the deteriorating US trade balance (reflecting the effects of administration policy choices on savings and investment), dissatisfaction with the status quo is likely to mount. Going forward, the Trump administration may impose simple rules in future trade agreements and misuse existing “good faith” commitments, exploiting size to extract concessions from trading partners.

In this respect, whatever benefit that moving to a trade-based enforcement regime might provide, such an approach entails a significant risk. Replacing rules-based IMF exchange rate surveillance, which is subject to governance arrangements that safeguard the interests of smaller countries and is based on IMF analysis, with currency manipulation clauses gives the larger country leverage over smaller trading partners. Moreover, such clauses are themselves subject to abuse. Smaller countries lacking analytical capacity and possibly threatened by the loss of trade access would be at a disadvantage in a dispute over currency manipulation. Global trade might contract, as countries self-select into regional trading blocs, seeking the protection of larger partners, and a new era of managed trade designed to avoid large imbalances between countries or trading blocs could emerge.

Meanwhile, reliance on bilateral approaches to currency issues would erode the legitimacy of the IMF, reducing its ability to support a rules-based system for international finance. The ultimate effect of the US approach could thus be a weakening of a critical institution, one that has promoted international economic and monetary cooperation, and fostered growth and financial stability for the past seven decades.

An Alternative Approach

A more nuanced approach is required, one based on a realistic appreciation that exchange rates and trade balances are determined by the interaction of a range of factors.²⁵ And because they reflect multiple effects and the interplay of multiple markets, a multilateral approach is required. Such an approach would acknowledge that, while the IMF has the power of analytical authority, the effectiveness of its exchange rate surveillance is contingent on the willingness of members to abide by its policy advice. The IMF can consult with members, but its ability to compel a member to change policies is limited (unless that member is drawing on Fund resources). The problem is that the managing director's capacity to exert moral suasion is constrained: how far she goes in pressing one side of an exchange rate dispute constrains how far she can go with the other side. It is a question of balance — particularly in an era in which the legitimacy of the institution is questioned.²⁶ Sovereign members of the Fund will not abide to rules they have not agreed to in advance or that are applied arbitrarily. The problem confronting the IMF is that it does not have a clear set of mutually agreed rules to enforce.

Modalities of Earlier US Proposals

An alternative approach to exchange rates and external adjustment would be to revisit US proposals in the early 1970s to preserve the Bretton

25 This section draws on Cooper (1987).

26 Complaints that IMF quotas, which determine access to resources as well as governance voice, do not adequately reflect some members' size and importance are long-standing. These concerns are typically expressed in terms of Fund quotas that reflect the global economy of the mid-twentieth century, rather than the realities of the twenty-first century.

Woods system. At that time, there were existential concerns that the collapse of the system could result in considerable uncertainty and global financial instability.²⁷ Against this background, the Special Drawing Right (SDR) was created at the Fund to supply additional liquidity. It was clear, however, that the SDR would not address the fundamental confidence problem and that exchange rate realignments and other policy adjustments were required. IMF members sought to avoid the deflationary consequences of revaluation against the dollar. But the United States could not devalue without breaking the “golden fetter” tying the dollar to gold. If unilateral suspension of the dollar were to be avoided, some means of convincing other countries to contemplate a revaluation or other policy change was required.

Accordingly, in November 1972, the United States Treasury circulated a paper outlining general “principles” for enhancing exchange rate adjustment, rather than specific proposals.²⁸ In effect, these principles reflected desired outcomes of an effective international monetary system: most important, the maintenance of “reasonable balance” in international payments. Treasury proposals therefore established a set of indicators based on a target level of reserves for each country. If actual reserves deviated too widely from this target level, the country would be expected to take corrective action.

While exchange rate adjustments were presumed to be first on the policy menu, other actions would be permitted, subject to the proviso that: “The range of ‘acceptable policy measures’ for the system would...be limited to those consistent with market mechanisms and a liberal world trade and payments order. Exchange rate changes are not seen as the only, or necessarily the most desirable, means of adjustments in all cases” (Council of Economic Advisors 1973, 169).

Surplus countries could dismantle trade and capital controls, consistent with movement

27 It was clear that the status quo, marked by the Triffin dilemma, was unsustainable — protracted, large-scale reserve accumulation by foreign central banks led to a situation in which their dollar claims exceeded existing US monetary gold reserves, undermining confidence in the dollar peg to gold; yet, sustained US balance-of-payments deficits were needed to supply liquidity to a growing global economy. Barry Eichengreen (1992) notes that this paradox could easily be known as the Mlynarski dilemma, after Feliks Mlynarski, who identified a similar phenomenon in the context of the interwar gold standard.

28 See Council of Economic Advisors (1973).

toward a liberal trade and payments system, but countries in deficit should refrain from imposing restrictions on capital movement. In other words, the approach would advance the broad goals of Bretton Woods. The proposals contemplated far greater exchange rate flexibility, including wider bands of fluctuation around a particular parity and even transitional floating between parities. Revaluations would be permitted at any time; devaluations would be permitted only if reserves fell below their target level.

But as the discussion above points out, enforcement is a key issue associated with any cooperative arrangement. And, while the above measures could be adopted at the discretion of individual members, the Treasury paper included a proposal by which the IMF could sanction a country whose reserves rose too far above the target. The IMF could, it was suggested, authorize the imposition of a general import tax or surcharges, withhold a scheduled SDR allocation, or tax excess reserves, with the proceeds going to development assistance. At the same time, sanctions could be avoided if the Fund decided that a country was pursuing an agreed program of adjustment, including liberalization of import restrictions or capital outflows, increases in untied foreign assistance as well as currency revaluation.

The US proposals were designed to align incentives facing members of the Bretton Woods system such that individual countries would be encouraged to adjust exchange rates earlier, rather than later, when the political costs of adjustment might be viewed as too great. In this respect, they would have been a marked improvement over the ad hoc measures and, increasingly, political threats that were used to keep the system together. But the Treasury paper did not spell out how the system would operate in practice. Most important, little guidance was given on the critical question of what would constitute the appropriate level of reserves.²⁹

Other members of the international community undoubtedly viewed the US proposals with suspicion: they feared the capital losses on their reserve holdings that would result from a unilateral suspension of the dollar's anchor to gold, yet feared

the deflationary consequences of revaluation — especially as they viewed the problem as one of US policies that were inconsistent with the dollar's role as global monetary anchor. Fundamentally, the debate was over who would bear the burden of adjustment. In the end, the proposals were overtaken by events, as President Nixon suspended the dollar's peg to gold and introduced an across-the-board import surcharge. And while the United States revived the indicators approach in proposals to the Group of Ten in the mid-1980s, generating considerable debate and study, the initiative did not go further.³⁰

Back to the Future?

Recent US trade measures are vaguely reminiscent of Nixon's unilateral decision to break the dollar's peg and raise tariffs. Both sets of actions reflect dissatisfaction with prevailing arrangements covering international trade and finance. However necessary to address what was an unsustainable situation, Nixon's go-it-alone decision ushered in a period of financial volatility. Likewise, the Trump administration's zero-sum perspective risks a serious policy error that could generate economic and financial disruption. This is because the international arrangements that Trump is intent on unwinding provide guardrails for the global economy, limiting the downside effects of possible shocks. Their loss could result in a much worse outcome.

The challenge is magnified by underlying shifts in relative economic weight from the industrialized economies at the core of the global economy to emerging economies at the periphery. Over time, this transition could entail a diminished role for the US dollar in international trade and finance. This would raise a fundamental “couldn't, wouldn't” question about the public good of international financial stability and the provision of global lender-of-last-resort facilities.³¹ The IMF was created to provide this role. Its ability to do so could be seriously weakened by

29 Answers to several questions were required: Would, say, the same rules governing reserve targets apply to countries already at full employment and countries, such as Japan, that at the time were growing rapidly by virtue of long-term convergence? How would the United States, which issued the reserve currency, be treated? Would it be allowed to enjoy its exorbitant privilege?

30 See Crockett and Goldstein (1987).

31 In his seminal account of the propagation and transmission of global stagnation in the Great Depression of the 1930s, Charles Kindleberger (1986) observed that in 1929, the Bank of England “couldn't” and the Federal Reserve “wouldn't” provide the public good of international financial stability. The Bank of England couldn't because its reserves had been depleted by World War I. The Fed wouldn't because it was a nascent institution, mindful of “foreign entanglements.”

US unilateralism, leaving the global economy seriously exposed to possible threats.³²

Resurrecting the earlier US proposal to reanimate international cooperation on exchange rates and external adjustment could take out insurance against this risk. But such an approach needs agreement on specifics. To begin, this would entail agreement on the level of “prudential” reserves at which the authorities would be obliged to refrain from foreign exchange intervention (allowing adjustment to come through nominal exchange rate adjustment, or higher domestic inflation). These target levels would obviously have to reflect the complexities of myriad factors behind exchange rate determination and external imbalances; the simple rules discussed above would not suffice. IMF analysis can guide the way.³³

A reserve-based approach has an excellent pedigree. In particular, it is fully consistent with the underlying objective of the IMF, which was created to assist national governments achieve full employment by easing the external constraints imposed by the dysfunctional interwar gold standard. By pooling reserves through the IMF, countries could escape the “golden fetters” that limited the scope of governments to pursue domestic stabilization objectives (Eichengreen 1992). For John Maynard Keynes, one of the founders of the IMF, excessive reserve holdings meant that beneficial investments in housing, health and infrastructures would be forgone as purchasing power is trapped in a so-called “sterile” asset.³⁴

At the same time, a reserve-based approach to the issues of exchange rate surveillance and adjustment lends itself to enforcement. Consideration could be given to a transparent regime of penalties that provides incentives to observe IMF norms. Two variants could be considered. The first would tie reserve holdings to access. IMF members that exceed target levels could have their access to

32 A weakened IMF could be an unintended and unwelcomed consequence of administration actions, since the considerable influence it exerts over the Fund provides significant value added in terms of advancing US interests. Certainly, there are those in the administration who recognize this value. See Schadler (2017).

33 See IMF (2011).

34 Savings held in gold are non-productive, or sterile, whereas savings held in corporate bonds finance investment in productive capacity. The idea is closely allied with Keynes’ notion of the paradox of thrift; the experience with the dysfunctional gold standard of the interwar period greatly influenced the design of the Bretton Woods system (Keynes [1930] 2012).

Fund resources reduced according to some agreed formula. This penalty would have direct effects on members that are currently using, or face a probable need for, Fund resources. However, it would not bind members that do not have an actual or expected need for IMF assistance. Accordingly, a second potential penalty could “tax” excess reserve holdings by reducing voting power according to some pre-determined schedule. While both penalties are consistent with IMF objectives, they would engender considerable debate; they certainly could not be based on a simple rule and “one-size-fits-all” approach. Reserve target levels would have to reflect the full range of considerations discussed above, including level of economic development. Moreover, members would have to agree to the methodology for determining such rules in advance.³⁵

Strengthening the IMF’s role and avoiding clashes over external imbalances would clearly require careful consideration and lengthy debate — as well as give and take.³⁶ It could reasonably be asked why larger countries would agree to a system in which targets would be set based on imprecise and incomplete models of optimal reserve levels. This is a fair comment, although it should be noted that since the 2007 Decision on Surveillance and the Integrated Surveillance Decision, the IMF has

35 This framework of targets and penalties applies most clearly to cases of fixed exchange rates or heavily managed rates. While such regimes are the greatest source of trade disputes, they are not the norm; most large advanced and emerging market economies combine flexible exchange rates with inflation targeting. However, cases of persistent misalignment can arise if private capital flows do not adequately reflect underlying risks of unsustainability. For this reason, quantitative targets on reserves could be supported by a protocol for assessing cases in which a particular currency is believed to be sufficiently undervalued such that it poses a threat to international financial stability and growth even in the absence of excessive reserve accumulation. Such findings would be based on the principles of the Integrated Surveillance Decision. Under this approach, IMF members would agree to a range of conceptual models and supporting methodology for evaluating currencies. Consistent with the purpose of the Fund, the relevant indicator is the real exchange rate. Members would agree in advance on the “burden of proof” for a finding of significant misalignment — for example, three of five indicators, or five of eight different indicators, all signalling misalignment. Regardless of the evidentiary threshold that is eventually established (presumably not the criminal “beyond all reasonable doubt” burden for reasons discussed above), the finding of misalignment would trigger a series of escalating measures each designed to encourage appropriate policy actions. These might include start with publication of a formal notice of misalignment, possibly culminating in restrictions on voting rights. As in the case of reserve targets, corresponding obligations on reserve asset-issuing countries would need to be developed; the challenges involved in this undertaking should not be discounted.

36 The process would be similar to the political “horse trading” with respect to initial quotas and exchange rates at the Bretton Woods discussions in August 1944.

refined its models and methods for determining reserve adequacy.³⁷ Ultimately, however, it is again a question of the burden of adjustment. This is because the United States, as issuer of the key reserve currency, would not be bound by a reserve-based rule. Other countries are therefore unlikely to agree to it. The United States may reassert its traditional “it’s our dollar, but your problem” position, but others are likely to see future disputes over trade balances in terms of shifting the burden onto surplus countries (in direct contravention of Fund jurisprudence under the Bretton Woods rules, which placed the burden of adjustment squarely on deficit countries). In any event, US current account deficits will not be reduced if the underlying macroeconomic causes are not addressed.

Absent policy-led shifts in national savings through deficit reduction, there will be little adjustment. This assessment militates for obligations on US policy choices. Of course, the United States will not agree to constraints on fiscal policy that other countries would not accept. That said, for a cooperative approach to exchange rate enforcement and external adjustment to succeed, there have to be countervailing obligations. One way to finesse the impasse is to suspend penalties for excess reserve accumulation if the US fiscal stance is found to be inconsistent with long-term considerations and national and international financial stability, consistent with the integrated surveillance decision.³⁸

37 As one reviewer noted, while this work would not make assessments any less contentious, it does provide formidable analytical foundations for policy making. At the same time, the perverse incentives created by the current quota formula, which rewards countries with higher reserves in terms of both higher access to Fund resources and higher voting power, should be reviewed. Such effects are fundamentally inconsistent with the underlying rationale of the IMF as a mechanism by which to minimize the opportunity costs of holding reserves.

38 A key factor contributing to the global financial crisis a decade ago, too long overlooked, is the effect of large US deficits, which generated so-called “safe assets” used to increase financial system leverage. These US safe assets were readily absorbed in the reserves of China and other countries managing exchange rates, holding down bond yields and thwarting real exchange rate adjustment. With two critical relative prices (real exchange rates and real interest rates) thus firmly anchored by policy interventions, the stage was set for excessive risk-taking. See Haley (2009) for an early exposition of these effects.

Conclusion: A New Bretton Woods?

Recent US trade actions threaten to unravel the fabric of international trade and financial cooperation that has been woven over the past seven decades. The strategy is to revert to the zero-sum game of the 1930s in order to secure a bigger piece of the global pie. The use of currency manipulation clauses in bilateral and plurilateral trade agreements may contribute to the erosion of international cooperation. By weakening the WTO and the IMF, these actions could result in a shrinking pie as the global economy becomes balkanized with countries seeking protection in regional trading blocs and trade declines. Confidence in the de facto international lender of last resort could be shaken and the IMF rendered less effective. This scenario is highly worrisome in that it increases the risk of global financial instability.

Against this troubling background, a nuanced approach to trade balances that strengthens exchange rate surveillance and acknowledges the multilateral nature of the issues involved could reduce the risk. The approach proposed here presages a return to the principles on which the Fund was based — namely, international monetary cooperation on the “rules of the game” to facilitate the orderly adjustment of external (trade) imbalances.³⁹

The goal must be to identify and promote a cooperative solution, and encourage IMF members to engage in an open, frank discussion on a mutually agreeable set of rules governing adjustment. This reflects the fact that under the current “non-system” Fund members are free to choose their exchange rate arrangements. And while IMF exchange rate surveillance could find a currency is under (over) valued, there are no rules (implicit or explicit) on how to enforce adjustment.

39 Under the Bretton Woods system, the Fund supported monetary cooperation through short-term revolving credits that would assist countries strike the right balance between adjustment (reduction of domestic absorption) on the one hand, and financing on the other. It was hoped this would encourage members to eschew policies destructive of national and international prosperity. This rationale remains relevant, although with the advent of capital account crises in the 1990s, the definition of adjustment must be broadened to include “adjustment” of private sector claims. See Haley (2014).

Sovereign states will not agree to a system in which the rules are unclear, and enforcement of them uneven. Agreement on targets for prudential reserve levels is one element of a possible broader deal.

The proposal would restore the role of the IMF as guardian of rules-based agreements that benefit all countries that play by the rules. In effect, it is a blueprint for a new Bretton Woods agreement that would help set the rules of the game of international finance for the twenty-first century. Success would reduce the risk of international financial stability. Failure would temporize with threats comparable to those the international community confronted in the dark days of the Great Depression compounded by the absence of an effective international lender of last resort.

The challenge is great. Seventy-five years ago, countries met the challenge and created a framework for international monetary and financial stability that facilitated their pursuit of full employment. They were guided by a US hegemon that sought to provide the leadership needed to transform the global economy from a zero-sum game to a positive-sum game that benefits all who play by the rules. Today, the enlightened self-interested leadership that led to the current rules-based system is sorely lacking.

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Annex: Exchange Rate Undertakings, CUSMA and the TPP

CUSMA	TPP Joint Declaration
General Provisions	
<p>The Parties affirm that market-determined exchange rates are fundamental for smooth macroeconomic adjustment and promote strong, sustainable, and balanced growth.</p> <p>The Parties recognize the importance of macroeconomic stability in the region to the success of this Agreement and that strong economic fundamentals and sound policies are essential to macroeconomic stability, and contribute to strong and sustainable growth and investment.</p> <p>The Parties share the objective of pursuing policies that strengthen underlying economic fundamentals, foster growth and transparency, and avoid unsustainable external imbalances.</p>	<p>We also recognize the importance of orienting our fiscal and monetary policies toward meeting domestic objectives, with due regard for the effects of our policies on other TPP countries. We further recognize that allowing real exchange rates to adjust in line with economic fundamentals facilitates smooth macroeconomic adjustment, helps to avoid prolonged external imbalances, and promotes strong, sustainable, and balanced global growth.</p> <p>To this end, our objective is to promote, through transparency and dialogue, market-determined and transparent exchange rate regimes that allow real exchange rates to adjust to reflect underlying economic fundamentals.</p> <p>We further recognize that excessive volatility in capital flows can create policy challenges that may require a policy response.</p>
Scope	
<p>This Chapter does not apply with respect to the regulatory or supervisory activities or monetary and related credit policy and related conduct of an exchange rate or fiscal or monetary authority of a Party.</p>	
Exchange Rate Practices	
<p>Each Party confirms that it is bound under the IMF Articles of Agreement to 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.</p> <p>Each Party should:</p> <p>(a) achieve and maintain a market-determined exchange rate regime;</p> <p>(b) refrain from competitive devaluation, including through intervention in the foreign exchange market; and</p> <p>(c) strengthen underlying economic fundamentals, which reinforces the conditions for macroeconomic and exchange rate stability.</p> <p>Each Party should inform promptly another Party and discuss if needed when an intervention has been carried out by the Party with respect to the currency of that other Party.</p>	<p>Each Authority confirms that its country is bound under the Articles of Agreement of the International Monetary Fund (IMF) to 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.</p> <p>Each Authority is to take policy actions to foster an exchange rate system that reflects underlying economic fundamentals, and avoid persistent exchange rate misalignments.</p> <p>Each Authority will refrain from competitive devaluation and will not target its country's exchange rate for competitive purposes.</p>

CUSMA	TPP Joint Declaration
Transparency and Reporting	
<p>Each Party shall disclose publicly:</p> <p>(a) monthly foreign exchange reserves data and forward positions according to the IMF’s Data Template on International Reserves and Foreign Currency Liquidity, no later than 30 days after the end of each month;</p> <p>(b) monthly interventions in spot and forward foreign exchange markets, no later than seven days after the end of each month;</p> <p>(c) quarterly balance of payments portfolio capital flows, no later than 90 days after the end of each quarter; and</p> <p>(d) quarterly exports and imports, no later than 90 days after the end of each quarter.</p> <p>Each Party shall consent to the public disclosure by the IMF of:</p> <p>(a) each IMF Article IV Staff Report on the country of the Party, including the exchange rate assessment, within four weeks of the IMF Executive Board discussion; and</p> <p>(b) confirmation of the Party’s participation in the IMF COFER database.</p> <p>If the IMF does not disclose publicly any items listed in paragraph (2) with respect to a Party, that Party shall request that the IMF disclose publicly those items.</p>	<p>Each Authority will disclose publicly</p> <p>(a) Each IMF Article IV Staff Report on its country, including the exchange rate assessment, within four weeks of the IMF Executive Board consideration;</p> <p>(b) Monthly foreign-exchange reserves data, including forward positions, according to the IMF’s Special Data Dissemination Standard (“SDDS”) template, no later than 30 days after the end of each month;</p> <p>(c) No less frequently than quarterly intervention in spot and forward foreign exchange markets, in a manner that provides appropriate transparency, no later than three months after the end of each quarter;</p> <p>(d) Quarterly balance of payments portfolio capital flows, no later than 90 days after the end of each quarter;</p> <p>(e) Quarterly domestic “broad” money stock, no later than 90 days after the end of each quarter;</p> <p>(f) Quarterly exports and imports, no later than 90 days after the end of each quarter; and</p> <p>(g) Confirmation that it is participating in the IMF Currency Composition of Official Foreign Exchange Reserves (“COFER”) database.</p>
Macroeconomic Committee	
<p>The Parties hereby establish a Macroeconomic Committee composed of principal representatives of each Party. Article 30.2.2(b) (Functions of the Commission) does not apply to the Macroeconomic Committee.</p> <p>The Macroeconomic Committee shall monitor the implementation of this Chapter and its further elaboration.</p> <p>The Macroeconomic Committee shall meet within one year after the date of entry into force of this Agreement, and at least annually thereafter, unless the Parties decide otherwise.</p> <p>The Macroeconomic Committee shall, at each annual meeting, consider:</p> <p>(a) the macroeconomic and exchange rate policies of each Party, and their consequences on diverse macroeconomic variables, including domestic demand, external demand, and the current account balance;</p> <p>(b) issues, challenges, or efforts to strengthen capacity with respect to transparency or reporting; and</p> <p>(c) undertaking other activities as the Macroeconomic Committee may decide.</p> <p>At each annual meeting, or as necessary, the Macroeconomic Committee may consider whether any provisions of this Chapter, except Article 33.3 (Scope), should be amended to reflect changes in monetary policy and the financial markets or should be interpreted. A decision by consensus of the Macroeconomic Committee that a provision of this Chapter should be amended shall be deemed to be a decision by consensus of the Commission to amend the provision. Amendments shall enter into force as provided for in Article 34.3 (Amendments). An interpretation issued pursuant to a decision by consensus of the Macroeconomic Committee shall be deemed to be an interpretation issued pursuant to a decision by consensus of the Commission.</p> <p>The Commission shall not take any decision to amend or interpret a provision of this Chapter except as provided in paragraph 5.</p>	<p><i>Multilateral dialogue.</i> The Authorities hereby establish a Group of TPP Macroeconomic Officials (the “Group”). The principal representative of each Authority is to be a senior macroeconomic policy official.</p> <p>The Group is to meet at least annually, or as provided below.</p> <p>This Group is to conduct its meetings in a mutually respectful manner and may consider appropriate modalities for the conduct of the meetings from time to time. Bilateral discussions with respect to Section I or II above do not preclude an Authority from raising such issues with the Group.</p> <p>The Group will, at its annual meetings, consider the macroeconomic and exchange rate policies of each TPP country, especially the effects of such policies on other TPP countries; issues or challenges with respect to transparency or reporting; and the policy responses which address imbalances.</p> <p>The Group is to prepare and publish reports, communiqués, or other documents regarding the meeting and any conclusions that reflect the collective views of the Group.</p>

Principle Representative Consultations

A principal representative of a Party may request expedited bilateral consultations with a principal representative of another Party with respect to policies or measures of another Party that the principal representative of the requesting Party considers associated with competitive devaluation, the targeting of exchange rates for competitive purposes, fulfillment of the transparency and reporting commitments in Article 33.5 (Transparency and Reporting), or any other issue that the principal representative of the Party may wish to raise with respect to Articles 33.4 (Exchange Rate Practices) or 33.5 (Transparency and Reporting). A Party engaged in bilateral consultations may invite the Party not engaged in those consultations to participate and provide input.

If a principal representative of a Party requests bilateral consultations, the principal representatives (or their designees) of the consulting Parties shall meet within 30 days of the request to arrive at a mutually satisfactory resolution of the matter within 60 days of their initial meeting.

If a principal representative of a Party requests bilateral consultations with respect to another Party's fulfillment of the transparency and reporting commitments in Article 33.5 (Transparency and Reporting), whether circumstances disrupted the practical ability of the other Party to disclose publicly the items listed in that Article shall be taken into account in the consultations, with the objective of arriving at a mutually satisfactory resolution of the matter.

If there is failure to arrive at a mutually satisfactory resolution in any consultations under this Article, the consulting Parties may request that the IMF, consistent with its mandate:

- (a) undertake rigorous surveillance of the macroeconomic and exchange rate policies and data transparency and reporting policies of the requested Party; or
- (b) initiate formal consultations and provide input, as appropriate.

Dispute Settlement

A Party may have recourse to dispute settlement under Chapter 31 (Dispute Settlement), as modified by this Article, only with respect to a claim that a Party has failed to carry out an obligation under Article 33.5 (Transparency and Reporting) in a recurring or persistent manner and has not remediated that failure during consultations under Article 33.7 (Principal Representative Consultations).

When selecting panelists to compose a panel under Article 31.9 (Panel Composition), each disputing Party shall select panelists so that each panelist:

- (a) has served as a senior official of an exchange rate or fiscal or monetary authority of a Party or the International Monetary Fund; and
- (b) meets the qualifications set out in paragraphs (2)(b) through (2)(d) of Article 31.8 (Roster and Qualification of Panelists).

A panel established under Article 31.6 (Establishment of a Panel) to make a determination as to whether a Party has failed to carry out an obligation under Article 33.5 (Transparency and Reporting) in a recurring or persistent manner and has not remediated that failure during consultations under Article 33.7 (Principal Representative Consultations) and a panel reconvened to make a determination on the proposed suspension of benefits, in accordance with Article 31.19 (Non-Implementation – Suspension of Benefits), may seek the views of the IMF in accordance with Article 31.15 (Role of Experts).

When a panel's determination is that a Party has failed to carry out an obligation under Article 33.5 (Transparency and Reporting) in a recurring or persistent manner, and has not remediated that failure during consultations under Article 33.7 (Principal Representative Consultations), the complaining Party may not suspend benefits that are in excess of benefits equivalent to the effect of that failure. In suspending benefits under Article 31.19 (Non-Implementation – Suspension of Benefits), the complaining Party may take into account only the failure to carry out an obligation under Article 33.5 (Transparency and Reporting) and not any other action or alleged failure by the responding Party.

Source: www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusma-aceum/r-cusma-33.pdf and www.treasury.gov/initiatives/Documents/TPP_Currency_November%202015.pdf.

About CIGI

We are the Centre for International Governance Innovation: an independent, non-partisan think tank with an objective and uniquely global perspective. Our research, opinions and public voice make a difference in today's world by bringing clarity and innovative thinking to global policy making. By working across disciplines and in partnership with the best peers and experts, we are the benchmark for influential research and trusted analysis.

Our research initiatives focus on governance of the global economy, global security and politics, and international law in collaboration with a range of strategic partners and have received support from the Government of Canada, the Government of Ontario, as well as founder Jim Balsillie.

À propos du CIGI

Au Centre pour l'innovation dans la gouvernance internationale (CIGI), nous formons un groupe de réflexion indépendant et non partisan doté d'un point de vue objectif et unique de portée mondiale. Nos recherches, nos avis et nos interventions publiques ont des effets réels sur le monde d'aujourd'hui car ils apportent de la clarté et une réflexion novatrice pour l'élaboration des politiques à l'échelle internationale. En raison des travaux accomplis en collaboration et en partenariat avec des pairs et des spécialistes interdisciplinaires des plus compétents, nous sommes devenus une référence grâce à l'influence de nos recherches et à la fiabilité de nos analyses.

Nos projets de recherche ont trait à la gouvernance dans les domaines suivants : l'économie mondiale, la sécurité et les politiques internationales, et le droit international. Nous comptons sur la collaboration de nombreux partenaires stratégiques et avons reçu le soutien des gouvernements du Canada et de l'Ontario ainsi que du fondateur du CIGI, Jim Balsillie.

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