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Trump Leaves Biden Administration a Parting Gift in Currency Wars

The Treasury's decision to label both Switzerland and Vietnam currency manipulators was unusual—and leaves the Biden administration with some tough choices to make.

BY JOSEPH W. SULLIVAN

The U.S. Treasury Department's decision this week to label both Vietnam and Switzerland currency manipulators lacked precedent and raised plenty of eyebrows. Labeling even one country a manipulator is a rare and headline-grabbing event. Until now, the administration of U.S. President Donald Trump had named only one country, China, a currency manipulator—only to remove it later. Never had the Treasury designated two countries in one fell swoop.

You could be forgiven for having expected a more vigorous overhaul of U.S. policies on currency manipulation during the Trump administration. After all, in 2015, Trump vowed to name China a currency manipulator on his first day in the Oval Office. As president, he launched accusations of currency manipulation on Twitter. Decrying the United States' trade deficits, he overhauled decades of official U.S. policy on trade. And if one's goal is to reduce the overall trade deficit, the natural complement to trade policy becomes currency policy.

Still, given the lack of real follow-through to official changes to U.S. currency policy, it would be tempting to interpret this week's designations as a last-ditch quack of disruption by a lame-duck administration. To the contrary, this action underscores the continuity of currency manipulation policy under Trump, which underwent only minor tweaks of the Treasury Department rules formulated under the administration of former President Barack Obama.

So why label Switzerland and Vietnam—and only those two countries—as currency manipulators now? For starters, the Treasury Department's hands were tied in a way that, like the announcement itself, lacked precedent. Since the 2015 legislation requiring the Treasury to promulgate specific criteria for identifying currency manipulation came into effect, Switzerland and Vietnam are the only two countries ever to meet all three of the Treasury's criteria: running a big trade surplus with the United States, running a large current account surplus, and intervening heavily in foreign-exchange markets to artificially weaken a currency. For context, China was labeled a currency manipulator after meeting only one of the three.

If the Treasury declined to name Vietnam and Switzerland manipulators now, after they met all three conditions, it'd be making a mockery of its own currency manipulation regime. Technically, one might even argue that the Treasury would run afoul of the law if it did not label countries manipulators once they meet all of its own criteria. (A handful of other countries that met two of the three conditions—including Germany, Japan, and South Korea—are on a watchlist, according to the Treasury.)

Two of the Treasury's three criteria address the types of trade imbalances that can emerge for any number of reasons and in lots of countries. Vietnam and Switzerland have met these criteria before: that, in the past 12 months, the country have run a bilateral trade surplus in goods with the United States of at least $20 billion and that it have an overall current account surplus of 2 percent of its gross domestic product.

But it was the third criterion that nailed Vietnam and Switzerland. If a country undertakes "persistent, one-sided intervention" to weaken its currency by at least 2 percent of GDP over a 13-month period and already meets the other two conditions, the Treasury effectively then has to label it a currency manipulator.

Both Switzerland and Vietnam recently differentiated themselves from the pack in this regard. Between July 2019 and June 2020, the time frame considered in the latest report, the Treasury estimates that Switzerland's intervention in the foreign exchange market, to the tune of $103 billion, amounted to a whopping 14 percent of its GDP. Vietnam's $16.8 billion intervention was equivalent to 5.1 percent of its GDP. (If an economy the size of the United States had fiddled in currency markets on that scale, it would mean interventions on the order of $1 trillion to $2.9 trillion.)

Why were they now trying so hard to push their own currencies down? Vietnam, a rising export power, has a history of undervaluing its currency, as the Office of the U.S. Trade Representative recently alleged in opening a Section 301 investigation into the country. A cheaper currency means more competitive exports.

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In the case of Switzerland, all the global carnage and disruption caused by the COVID-19 pandemic played to the Swiss franc's reputation as a safe haven, inducing sharp upward pressure on the currency. But a stronger franc would mean lower prices in Switzerland, threatening to turn negligible Swiss inflation, already less than half of 1 percent in 2019, negative. And negative inflation—deflation—triggers a vicious cycle of economic contraction. Inflation may induce anxiety on Wall Street, but deflationary spirals are (and were) the stuff of great depressions.

U.S. policymakers, it seems, do feel empathetic toward Switzerland's plight. The Treasury's own report acknowledges the Swiss currency interventions as a response to "persistent deflationary risks" at home and an attempt to avoid "negative impacts on inflation and domestic growth." But empathy for a foreign central bank does not exonerate its behavior from judgment by the U.S. Treasury Department, if that behavior is at least in part for "purposes of preventing effective balance of payments adjustments."

And there are other potential pitfalls that may come from the Treasury report. While acknowledging Switzerland's legitimate growth and inflation concerns, the report said that Swiss authorities can reduce the need for unconventional monetary policy "by raising labor force participation rates and productivity growth." But faulting other countries for relying on monetary policy to shore up deficiencies elsewhere may soon come back to bite Washington. For instance, the United States faced complaints of currency manipulation from countries such as Brazil in response to the Federal Reserve's quantitative easing program, which helped shore up a tottering

U.S. economy but had the effect of weakening the dollar. Today, the dollar is again weakening as the Federal Reserve undertakes unconventional measures to help a U.S. economy in a crisis. The United States, then, may soon find itself hearing the Treasury's critique of Switzerland turned back on itself.

The United States may soon find itself hearing the Treasury's critique of Switzerland turned back on itself.So what happens next between the United States and these two countries? The only certainty is that the Treasury will conduct "enhanced bilateral engagement" with each country that "will include urging the development of a plan with specific policy actions to address the underlying causes" of external imbalances.

But there is little chance that either country addresses those "underlying causes," even if the United States were to threaten more than loss of access to government procurement programs. In undervaluing its currency, Vietnam's authoritarian government is choosing to decrease how much stuff every Vietnamese citizen can buy in order to have fewer unemployed. In Switzerland, the national government tends not to issue bonds because it eschews budget deficits that need financing. This is one reason the Swiss central bank turns to currency interventions, rather than purchases of government bonds, to try to save its economy from deflation. In both countries, the external imbalances have deep roots in the foundations of domestic governance. They're unlikely to change due to a semiannual Treasury report.

Instead, the most likely legacy of this announcement likely lies in its effect on government in the United States. Inheriting these "enhanced bilateral engagements," the likely next Treasury secretary, Janet Yellen, and her colleagues may well choose to continue them. In that case, the Treasury starts off with the gift of an existing bilateral forum in which to press Switzerland and Vietnam even on issues unrelated to currencies per se. If, however, the Biden administration symbolically delists the countries without extracting any concessions right away, they'll start off by making a mockery of the Treasury's existing currency manipulation regime. Either way, the clock on Biden's first shot at currency policy is shorter. But the Trump administration now leaves behind a situation that could embarrass any Biden administration eager to soften U.S. policy on currency manipulation.

After the past four years and the flurry of last-minute announcements, it's tempting to presume that all disruptions from U.S. policy are due to disruptions to that policy. But the Treasury's criteria on currency manipulators—despite all that has changed about U.S. international economic policy—are largely unchanged from the Obama administration and will continue at least into the Biden administration's opening days.

Joseph W. Sullivan *served at the White House Council of Economic Advisers as the special advisor to the chairman, as well as a staff economist, from 2017 to 2019. Now serving as a senior advisor at the Lindsey Group, he is a graduate of Harvard University*