THE TPP’s Missing Ingredient

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WASHINGTON, DC – Looking for ways to stimulate economic growth and create jobs, US President Barack Obama’s administration is seeking to press ahead with the mega-regional free-trade deal known as the Trans-Pacific Partnership (TPP). But is the US going about it the right way?

The TPP’s initial scope was relatively modest, involving the United States and a range of trading partners (Australia, Brunei Darussalam, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam). But now Japan is on board, South Korea is watching closely, and there is potential for engaging with China through this or a similar framework in the foreseeable future.

The typical approach when seeking to finalize an agreement aimed at reducing trade barriers – while attempting to protect labor and environmental standards – is to ask for less, not more, from those on the other side of the table. But at this stage, the TPP is different: the odds of success would be much greater if the US attached the additional requirement that participating countries do not engage in currency manipulation.

One of the major shortcomings of the global trading system in recent decades has been the absence of an effective constraint on countries that intervene heavily in order to keep their currencies undervalued. A significantly undervalued currency implies a potentially large trade surplus.

Ordinarily, a large surplus puts upward pressure on the country’s currency – making its exports less competitive and boosting demand for imported goods and services. But a country’s authorities can prevent appreciation for a prolonged period of time by buying up foreign currency.

Such intervention results in the accumulation of foreign-exchange reserves – much of which is held in the form of US government debt. In one way, this benefits the US by helping to keep interest rates lower than they would be otherwise. But currency manipulation is also an unfair way to gain a trading advantage, with excessive negative effects on trading partners.

The International Monetary Fund was founded, in part, to prevent precisely this type of beggar-thy-neighbor economic strategy, which resulted in “competitive devaluations” during the 1930s. Unfortunately, the IMF in recent years has proved unable or unwilling to do so.
Similarly, the US Treasury is legally required to determine if a country is intervening to an unfair and unreasonable extent. In practice, however, the Treasury’s reports on this issue are generally toothless and lead to no real consequences.

Fred Bergsten and Joseph Gagnon, my colleagues at the Peterson Institute, have proposed including a currency clause in any TPP deal. In essence, this would amount to the signatories agreeing not to manipulate their currencies. Such a clause could come with stronger or weaker teeth. The important thing is to shift norms and expectations.

Some US officials are supportive of this approach to the TPP; others are resisting it. But the skeptics should think hard about the likely dynamics in the US Congress when the TPP comes up for a vote. There is strong support on Capitol Hill, from both Democrats and Republicans, for finding some way to limit currency manipulation. Even people who are very much in favor of freer trade – and even of some version of the TPP, like Bergsten and Gagnon – believe that some Asian countries have overstepped the boundaries of reasonable behavior.

With the level of intervention by major countries currently limited (China) or non-existent (Japan), this is an ideal moment to include a currency clause in the TPP, as most countries are less likely to become defensive. Participating countries could allow their currencies to float, or they could operate a fixed exchange rate. In the latter case, however, they must commit not to run large current-account surpluses and accumulate excess foreign-exchange reserves. Any blatant and repeated violation of this commitment would – and should – result in the loss of the special privileges granted under the TPP.

Of course, how the politics plays out will depend on what happens in the US mid-term congressional elections in November, as well as how key figures position themselves for the presidential election in 2016. But both parties are generally interested in supporting free trade, along responsible lines – and recognize legitimate concerns.

Currency manipulation has become a little too ugly in recent years – with associated adverse effects on sectors and communities in the US – for elected representatives to ignore. It is to be hoped that the other TPP countries also come to understand that the agreement is more likely to work if it strongly discourages currency manipulation.