

RESEARCH SUMMARY

## Currency Manipulation and Trade Wars: Separating Fact from Fiction

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Much confusion surrounds what currency manipulation is and what are its implications for public policy. Scott Sumner dissects common misunderstandings in “[Currency Manipulation, Saving Manipulation, and the Current Account Balance](#).” He argues that currency manipulation is a misleading concept, as the underlying problem is better described as “saving manipulation.”

### CURRENCY MANIPULATION OR SAVING MANIPULATION?

“Currency manipulation” can refer to various policies that nations use to boost their trade balance. Many nations have tried to gain an advantage by simply depreciating their currency. However, any advantages that they gained were often erased by rising domestic prices. The only lasting way for governments to manipulate real exchange rates is by altering domestic investment or domestic saving.

Sumner suggests “saving manipulation” is a better way to view the issue because a persistent boost in the trade balance generally requires a higher rate of domestic saving. Policies that boost saving tend to depreciate the real exchange rate and thus increase the current account balance (i.e., boost the trade surplus).

Foes of currency manipulation worry that it can affect other countries in the following ways:

- Depressed levels of aggregate demand, as in the 1990s when inexpensive Chinese exports reduced demand for US goods
- Deindustrialization and structural unemployment that result from this reduced demand
- Excessive indebtedness and financial risks

Sumner argues that these worries are greatly overstated and that currency manipulation is not a problem that US policymakers need worry about.

### CHINA IS NOT TO BLAME FOR THE DECLINE IN US MANUFACTURING

The Trump administration has been a vocal critic of China’s trade policy. In effect, it has used currency manipulation as a scapegoat for the decline in domestic manufacturing employment. In an attempt to balance the bilateral trade between the two countries, the administration has imposed tariffs on China. However, this criticism fails to take into account the following:

- The deindustrialization of America’s Rust Belt was also the result of technological innovation and other changes.

- The “China shock”—the emergence of a 1.3-billion-person economy with a trade-friendly Communist government—is a rare occurrence that is not likely to be repeated.
- The comparative advantages of East Asian economies revolutionized world manufacturing; China’s high current account balance had little to do with it.

### **KEY TAKEAWAY**

Overall, US lawmakers should be skeptical about blaming currency manipulation for domestic problems. Instead of making temporary adjustments to nominal exchange rates or imposing tariffs and quotas, lawmakers should focus on domestic stabilization policies.