

Issue Brief

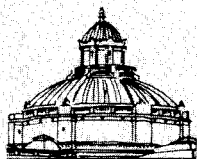
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EXCHANGE RATES: THE DOLLAR IN INTERNATIONAL MARKETS

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by

Arlene Wilson

Economics Division

Congressional Research Service

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EXCHANGE RATES: THE DOLLAR IN INTERNATIONAL MARKETS

SUMMARY

Mainstream economic theory suggests that the U.S. budget deficit was the main cause of the dollar appreciation between 1980 and early 1985. The high budget deficit forced the U.S. Government to compete against the private sector for available savings, raising interest rates in the United States. In response, net capital inflows to the United States increased, the demand for dollars on the foreign exchange market went up, and the dollar appreciated. Restrictive budgets and loose monetary policies abroad, both of which kept interest rates low abroad, also contributed to the dollar's appreciation over this period.

Most economists agree that a reduction in the U.S. budget deficit is the most effective way to reduce the value of the dollar. In addition, attention has focused on coordination of economic policies among the major industrial countries to reduce wide swings in exchange rates.

U.S. policy towards the dollar is the responsibility of the U.S. Treasury Department, except for fiscal policy, where the Congress has a large role. From 1980 to 1985, the Administration did not take an active role in exchange rate management, letting market forces determine the value of the dollar. In September 1985, however, the finance ministers and central-bankers of the G-5 countries (United States, United Kingdom, Germany, Japan and France), met (at the initiative of the United States) and announced a joint effort to reduce the dollar's value. Since then, the major industrial countries have met several times to coordinate policies, with a limited degree of success. Most recently, the G-7 (the G-5 countries plus Canada and Italy) met on April 8, in an attempt to stabilize the dollar at current levels.

In the 100th Congress, H.R. 3, Title IV, Subtitle A, the Competitive Exchange Rate Act of 1987, has stimulated considerable discussion. The purpose of this subtitle is to make exchange rate stability an important policy goal in the United States. To that end, Subtitle A, as reported, directs the President to negotiate with other countries on the exchange rate system, and encourages the Administration to intervene, as appropriate, in the foreign exchange market. Perhaps most important, Subtitle A requires a series of reports to Congress on the Administration's efforts to enhance exchange rate stability. S. 30, S. 452 and S. 490 and H.R. 532 also contain provisions on exchange rates.

ISSUE DEFINITION

The large dollar appreciation between 1980 and early 1985 was a major cause of the 1986 trade deficit of \$170 billion. Although the dollar has depreciated substantially since 1985 against the yen and the European currencies, it is not clear that the amount of dollar depreciation to date is sufficient to substantially reduce the trade deficit.

The 100th Congress is considering legislation to make the Administration more accountable for policies which affect exchange rates. The main issue for Congress is how to encourage (or require) the Administration to make exchange rates an important policy goal without inhibiting the flexibility of the Administration in achieving other goals, such as restraining inflation.

BACKGROUND AND ANALYSIS

Explanation of Exchange Rates

An exchange rate is the price of one currency in terms of another currency. For example, assume the exchange rate between the U.S. dollar and the German Deutsche mark (DM) is \$1=DM 2.50, which can also be expressed as DM 1=\$.40. If the dollar subsequently buys more DMs, the dollar has appreciated (and the DM depreciated). For example, if one dollar buys DM 2.50 in one time period, and later buys DM 3, the dollar has appreciated.

The foreign exchange market, where one currency is exchanged for another, is a network of commercial banks, brokers, central banks, and customers who communicate easily and quickly with each other. Foreign exchange markets exist in most financial cities in the world and are closely linked to markets in other cities and countries by telephone and telex. Arbitrage (the buying of a currency in one market and simultaneously selling it in the same or different markets to take advantage of prevailing price differentials) insures that exchange rates are very close in all cities in the world.

If exchange rates are determined in a free market (no government intervention), the supply and demand for dollars determines the exchange rate. The supply and demand for dollars, in turn, depends on the demand for underlying transactions, such as exports, imports, and international capital flows. For example, if the demand for U.S. exports increases, and everything else remains the same, the demand for dollars to pay for the increased exports will go up, causing the dollar to appreciate. Similarly, if foreigners decide to buy more U.S. securities, and everything else remains the same, the demand for dollars to pay for the additional securities increases and the dollar appreciates. Many other types of international trade and financial transactions affect the dollar's exchange rate.

From 1945 to 1973, exchange rates among countries were fixed, in accordance with the international agreement reached at Bretton Woods, New Hampshire in 1944, which also established the International Monetary Fund

(IMF). Under the Bretton Woods system, the value of the dollar was defined in terms of gold (and convertible into gold) and all the other currencies were fixed in relation to the dollar. The exchange rate for each currency could fluctuate only one percent above or below the fixed value of the currency. Each country was expected buy or sell its own currency (intervene in the foreign exchange market), if necessary to prevent wider fluctuations. In cases of fundamental disequilibrium in a country's balance of payments (exports and imports of goods and services and financial flows among countries), a country was permitted to devalue or revalue its currency (change the fixed rate).

In the late 1960s, U.S. balance of payments deficits became large and speculation against the dollar became severe. Fixed exchange rates were abandoned in March 1973, and each country now determines whether its currency will be fixed, floating, or some variant of the two.

The current system is termed the "floating (or flexible) exchange rate system" even though only a relatively few countries allow their currencies to fluctuate freely. The major industrial countries either allow their currencies to float independently (the United States, Canada, Japan and the United Kingdom) or participate in the European Monetary System (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands) in which flexibility among the participating countries is limited, but their currencies float with respect to non-EMS currencies.

In the early 1970s, when the floating exchange rate system was relatively new, it was thought that exchange rates were determined mainly by trade flows (capital flows were relatively small and often restricted). Trade flows, in turn, were thought to be determined mainly by relative real incomes and relative prices. For example, according to this theory, if real income in the United States increases relative to that abroad, U.S. imports will increase, leading to a worsened U.S. current account balance, an increased supply of dollars on foreign exchange markets and a dollar depreciation. Or, if U.S. prices fall relative to those abroad, U.S. exports will increase, U.S. imports will decrease, the U.S. current account will improve and the dollar will appreciate.

In recent years, however, capital flows have increased substantially and most analysts believe they are the major factor in the determination of exchange rates. For example, a foreign exchange survey by the Federal Reserve Bank of New York shows that foreign exchange transactions in the United States were about 10 times the sum of annual U.S. exports plus imports in 1983. Based on balance of payments data, net capital inflows into the United States were about \$118 billion in 1985. Capital flows are motivated mainly by differences among countries in actual or anticipated interest rates and exchange rates, and by perceptions of economic and political stability in different countries.

Under floating exchange rates, economic policies and performance in the United States and abroad ultimately determine exchange rates. As a result, changes in monetary or fiscal policies may have a substantial effect on exchange rates. For example, tight monetary and loose fiscal policy may lead to high real interest rates, capital inflows, and an appreciation of the currency. Most analysts argue that the U.S. budget

deficit was the major cause of the dollar's appreciation from 1980 to 1984.

In addition to changing monetary and fiscal policies, governments can intervene (buy and sell foreign currencies in the foreign exchange market) to influence the exchange rate. Intervention by itself is thought to have only a small effect on exchange rates, but may be a useful supplement to economic policy changes. Although the U.S. Treasury has ultimate responsibility for intervention, the decision to intervene is usually made jointly by the U.S. Treasury and the Board of Governors of the Federal Reserve System. The actual buying and selling of currencies is done by traders at the Federal Reserve Bank of New York.

Magnitude of Exchange Rate Fluctuations

The amount of depreciation (or appreciation) of the dollar differs substantially depending on which currencies it is measured against. In fact, the dollar may depreciate against one currency, while at the same time it is appreciating against other currencies.

The dollar hit an all-time high on Feb. 25, 1985. Since then, it has been depreciating substantially against the European currencies and the yen. When measured against the currencies of some of the other major trading partners of the United States, however, the results have been quite different. It should be noted that some currencies, such as the South Korean won and the Taiwan dollar, do not float freely, but are closely linked to the dollar.

To determine the overall depreciation or appreciation of the dollar, a trade-weighted average, in which the dollar is measured against a number of currencies, each weighted by its share in U.S. trade or in world trade, is used. Trade-weighted averages are computed by the International Monetary Fund, the Federal Reserve Board, the Federal Reserve Bank of Dallas, and Morgan Guaranty Trust, among others.

The various trade-weighted averages have differed considerably regarding the magnitude of the dollar depreciation since February 1985. Although differences can be caused by several factors, such as whether each currency is weighted by its share in U.S. trade or in world trade, two reasons stand out as most important. First, the number and choice of currencies that are included in the average is significant.

Second, whether or not the average is in nominal or real (inflation-adjusted) terms may be crucial. Real exchange rates measure the rate of exchange between U.S. goods and foreign goods because they take into account both exchange rate changes and changes in price levels, while nominal exchange rates measure the rate of exchange among currencies only. The volume of exports and imports depends on real, not nominal, exchange rates. The dollar often appreciates against a currency (such as those in Latin America) because the rate of inflation abroad is far greater than in the United States. If a trade-weighted average includes countries with widely different rates of inflation, real exchange rates are more meaningful than nominal exchange rates.

The Federal Reserve Board's monthly trade-weighted index, which measures the change in the dollar against the currencies of Canada, Japan, the U.K., Germany, France, Italy, Belgium, the Netherlands, Switzerland and Sweden, is widely used. Although this index is in nominal terms, the inflation rates of the countries whose currencies are included do not differ substantially; consequently, it approximates an index of real exchange rate changes.

Between Feb. 25, 1985, and Apr. 14, 1987, the percentage change in the nominal exchange rate of the dollar for five major trading partners of the United States, along with the Federal Reserve Board's trade-weighted index, was:

Japanese yen	-46.5%
German DM	-48.0
Canadian dollar	- 5.6
South Korean won	+ 0.9
Taiwan dollar	-13.2
 Federal Reserve Board's trade-weighted index	 -41.6

What Caused The Dollar To Appreciate Between 1980 and Early 1985?

Mainstream economic theory suggests that the high U.S. budget deficit was the main cause of the dollar appreciation between 1980 and 1984. As the budget deficit increased, the U.S. Government competed against the private sector for available savings. Since monetary policy was relatively tight over much of this period, the supply of funds did not increase to finance the budget deficit. As a result, real (inflation adjusted) interest rates in the United States rose. This led to large net capital inflows from abroad, adding to the demand for dollars on the foreign exchange markets. Consequently, the dollar appreciated.

Although the U.S. budget deficit is considered by most economists to be the main cause of dollar appreciation, other causes have also been suggested. First, the United States is perceived as being considerably more stable, in both economic and political terms, than many other countries, and thus has been the recipient of foreign funds seeking a "safe haven." Second, the success of the United States in reducing inflation and increasing the profitability of investment may have contributed to net capital inflows.

Third, policies and the economic performance of other countries have influenced the demand for dollars. For example, tight fiscal policy in Germany has restrained economic activity in Germany, reducing the willingness of foreigners to invest in Germany. In the case of Japan, until 1985, monetary policy was loose and fiscal policy tight, keeping interest rates (already low because of interest rate restrictions on some financial instruments) lower than in the United States. This, together with the high savings rate in Japan, led to capital outflows to the United States, contributing to the dollar appreciation.

Finally, some analysts believe that part of the dollar appreciation reflects a "speculative bubble." In other words, dollar appreciation, once underway, builds up a momentum of its own, and purchasers buy dollars in hopes of selling them later at a higher price, not because of any underlying factors. In particular, some analysts theorize that the dollar appreciation between the middle or end of 1984 and February 1985, which appeared greater than was warranted by the fundamentals, reflected a speculative bubble. This theory is controversial, however, and many analysts do not accept it.

How Does Dollar Appreciation Affect the U.S. Economy?

Dollar appreciation makes U.S. exports less competitive abroad by raising their foreign-currency price. For example, a U.S. machine selling for \$100 would sell in Germany for DM 250 when the exchange rate is \$1=DM 2.5 and for DM 300 when the dollar appreciates to \$1=3.00. Similarly, the dollar price of U.S. imports declines when the dollar appreciates.

Sometimes an importer or exporter will absorb (and not "pass-through") part of the difference in price arising from exchange rate changes. Using the same example of a U.S. machine, assume the U.S. exporter reduces his dollar price (by taking a smaller profit) to \$90 when the dollar appreciates to DM 3. The German price of the machine then rises from DM 250 to DM 270, instead of DM 300. A study published in the Federal Reserve Bulletin in June 1986 indicated that the pass-through for U.S. exports is relatively high, while the pass-through for U.S. imports has been low in recent years.

Assuming that buyers are sensitive to price changes (known as "elastic demand"), a dollar appreciation will, after a time lag of one to two years, lead to a worsening of the U.S. trade balance. It is estimated that the dollar appreciation of 1980 to 1984 accounts for about one-half to two-thirds of the U.S. trade deficit (\$170 billion in 1986).

Dollar appreciation also reduces the U.S. rate of inflation, both directly and indirectly. The lower dollar price of U.S. imports directly lowers the Consumer Price Index. Indirectly, the lower price of U.S. imports may decrease the demand for import-competing goods, whose prices must be kept down to be competitive. Also, to the extent that imports are inputs in the production process, lower import prices reduce costs. Finally, lower prices may reduce union demands for higher wages. According to a study published by the Federal Reserve Bank of New York Quarterly Review, Autumn 1985, a 10% rise in the dollar reduces the Consumer Price Index by about 1.2% over a two-year period.

There is considerable anecdotal evidence that dollar appreciation stimulated many firms to locate plants abroad or to buy more of their materials abroad. There is no aggregate data on these shifts, however. To the extent that dollar appreciation is only temporary, these resource shifts are inefficient.

Finally, dollar appreciation has, some argue, stimulated increased protectionist pressures by exporters and import-competing firms who have lost sales. -

Dollar Depreciation Since February 1985

As discussed earlier, the dollar depreciated 42% on a trade-weighted basis against 10 currencies between February 1985 and Apr. 14, 1987. Changes in fundamental economic conditions were probably the major cause of the depreciation. Interest rate differentials narrowed substantially, the U.S. budget deficit began to decline, inflation rates converged, and economic growth improved abroad. The oil price decline may have reduced the demand for dollars since oil sales are denominated and paid for in dollars worldwide. Also Germany and Japan (who are large oil importers) were perceived to benefit more from the oil price decline than the U.S. Finally, the G-5 agreement on Sept. 22, 1985, may have convinced foreign exchange traders that dollar depreciation is likely.

It is widely expected that dollar depreciation will ultimately reduce the U.S. trade deficit. Several factors, however, may keep the trade deficit relatively high in 1987. First, the dollar has depreciated mainly against the Japanese yen and the major European currencies. When measured against the currencies of other major trading partners, such as the Canadian dollar, the South Korean won and the Taiwan dollar, the U.S. dollar has remained about the same. Second, during the dollar appreciation of 1980-84, foreign suppliers absorbed exchange rate changes in their profit margins to a considerable extent, rather than lowering the dollar price of U.S. imports. This means that foreign suppliers are now able to take lower profits, and the pass-through of the dollar depreciation to the dollar price of U.S. imports may be relatively low.

The sudden depreciation of the dollar in January 1987 and again in April 1987 raised concerns about the possibility of higher interest and inflation rates in the United States. A dollar depreciation reflects fewer capital inflows into the United States, which would increase U.S. interest rates. Also, rapid dollar depreciation raises the dollar price of U.S. imports in a short period of time, and other sectors of the economy often follow with price increases, too.

Policy Options

Reduce the Budget Deficit

Most analysts agree that a reduction in the U.S. budget deficit would be the most effective method of reducing the value of the dollar. If, as is argued, the budget deficit leads to high interest rates, which attracts foreign capital, then progress to reduce the deficit would reduce pressure on interest rates, and lead to fewer capital inflows and a lower dollar.

Coordinate Economic Policies Among Major Industrial Countries

Coordination among the major countries of monetary and fiscal policies would probably reduce the divergence between relative economic growth rates, inflation rates, and interest rates. According to most analysts, this would lead to smaller differentials among countries in their trade and current account balances and interest rates, and to fewer destabilizing capital flows.

A major problem with this option is that governments would have to agree on the goals of macroeconomic policies and have the political will to coordinate policies. Recently, the main forum for international policy coordination has been the meetings of the central bankers and finance ministers of the G-5 countries (United States, United Kingdom, France, Germany and Japan), G-6 countries (G-5 plus Canada) or G-7 countries (G-6 plus Italy) on Sept. 22, 1985, Feb. 22, 1987, and Apr. 8, 1987. Although somewhat successful, policy commitments have often been weak and were not always implemented.

Intervene in the Foreign Exchange Market

Intervention in the foreign exchange market by the central bank will, unless offsetting actions are taken, affect the domestic money supply. When offsetting actions are taken, the intervention is termed "sterilized"; the United States undertakes sterilized intervention when it intervenes.

Many studies have been made of the effects of sterilized intervention, and, although the results are inconclusive, it appears that sterilized intervention is ineffective, except for very short-run exchange rate changes. For example, a study released in April 1983 by the Working Group (established at the Versailles Economic Summit in June 1982) found that intervention could be important in reducing currency fluctuations in the short-run, but could have a long-run effect only if combined with economic policy changes.

Opponents of intervention argue that since foreign exchange markets are very large, compared to the relatively small amounts of intervention that central banks could undertake, intervention would be ineffective. Proponents of sterilized intervention argue that it might have a positive effect on expectations in the foreign exchange market, especially if intervention is coordinated with central banks of other countries, and if economic policy changes are carried out at the same time.

Impose Capital Controls

Since it is believed that net capital inflows were a major cause of the dollar's appreciation, some analysts argue that capital controls should be imposed, either by the United States or by other countries. Controls could take the form of a tax on capital flows, or on interest payments, or restrictions on the amount of capital flows. Opponents argue first, that since international capital is highly mobile, capital controls could be easily evaded and would not be effective. Second, capital controls would result in a inefficient allocation of savings among

countries. Third, if controls were imposed and effective while the U.S. budget deficit is high, capital inflows would decline, putting upward pressure on U.S. interest rates.

Establish a System of Target Zones

One current proposal is that central banks agree on an equilibrium exchange rate and establish a "target zone" of perhaps 10% above and 10% below the chosen exchange rate. Economic policies and foreign exchange intervention would then be directed at maintaining exchange rates within the target zone.

Proponents argue that target zones would increase the commitment of governments to exchange rate stability and would have a positive effect on private participants in the foreign exchange market, who, if the target zones were credible, would not take destabilizing actions. Opponents argue that it is too difficult to select an equilibrium exchange rate and the appropriate width of the target zone; if the target zone width is too large, it would have no effect, but if it were too small, it would not be sustainable.

Negotiate with Countries Which Maintain Undervalued Exchange Rates

Countries that intervene substantially in the foreign exchange market to maintain an undervalued exchange rate will, under most circumstances, experience an increase in their money supplies and ultimately a rise in the inflation rate. Although such countries will ultimately lose competitiveness in world markets as a result of their higher inflation rates, some argue that in the short run they will be more competitive, and thus negotiations to urge them to revalue their exchange rates are necessary.

U.S. Policy Toward the Dollar

U.S. policies towards the dollar are the responsibility of the executive branch or the Federal Reserve, except in the case of fiscal policy, where the Congress has a critical role. For example, the Federal Reserve can consider the value of the dollar when deciding on monetary policy. The Treasury Department has ultimate authority for determining the amount and timing of foreign exchange intervention, which may be effective in supplementing other policies. The executive branch can initiate or pursue discussions with other countries to coordinate macroeconomic policies, or discuss modifications in the floating exchange rate system, or persuade countries whose exchange rates are fixed (such as Taiwan and Korea) to let their currencies appreciate relative to the dollar.

From 1980 through 1984, the Administration did not take an active role in exchange rate determination. In 1985, however, the Administration's policy changed. Of most importance, the United States initiated the Plaza Accord of Sept. 22, 1985, in which the United States, Japan, Germany, the United Kingdom and France agreed to continue policies that would reduce the value of the dollar. Since late July 1986, the U.S.

Treasury Department has been engaged in informal discussions with the Government of Taiwan and South Korea regarding their undervalued exchange rates. On Feb. 22, 1987, and Apr. 8, 1987, the United States and the other major industrial countries met and agreed that exchange rates would be stabilized at current levels.

Legislation in the 100th Congress

In the 99th Congress, a variety of bills were introduced requiring or directing the Administration to undertake monetary or fiscal policy changes, coordinate policies with other countries, intervene in the foreign exchange market or initiate an international monetary conference to reform the exchange rate system.

The main issue raised by these bills is the extent to which the Congress should require the Administration to use monetary or fiscal policy, to coordinate policies with other countries, or to intervene in the foreign exchange market, in order to influence exchange rates. Supporters of the bills argue that it is necessary to require the Administration to take action since they have not always done so when necessary in the past. Also, legislation would send a clear signal to the foreign exchange markets that excessive exchange rate fluctuations would not be permitted. Opponents maintain that such legislation would unduly restrict the flexibility of the executive branch, with possible adverse effects. Furthermore, legislation is not necessary since the Administration is currently coordinating policies with other countries (for example, in the Plaza Accord of Sept. 22, 1985, and the Paris Accord of Feb. 22, 1987).

One of the first legislative actions in the 100th Congress was the introduction of H.R. 3, the Trade, Employment and Productivity Act of 1987. This bill was almost identical to H.R. 4800, which passed the House on May 22, 1986 (in the 99th Congress). Title IV, Subtitle A of H.R. 3 makes exchange rate stability an important policy goal in the United States and increases the accountability of the Administration for economic policies that affect the exchange rate.

As reported, the main provisions of Title IV, Subtitle A, are:

- * Directs the President to confer and negotiate with other countries on the exchange rate system;
- * Directs the President to negotiate with countries whose currencies are pegged to the U.S. dollar to eliminate currency misalignments;
- * Encourages the U.S. Treasury to intervene, as appropriate, in the foreign exchange market;
- * Establishes extensive reporting requirements by the U.S. Treasury, partly to encourage debate on exchange rate policy.

S. 30, S. 452 and S. 490 in the Senate and H.R. 532 in the House also contain provisions on exchange rates. See the LEGISLATION section for further information.

LEGISLATION

H.R. 3 (Gephardt et al.)

Title IV, Subtitle A -- Competitive Exchange Rate Act of 1986. As introduced, requires international negotiations to reform the exchange rate system and to coordinate policies, requires foreign exchange intervention, and requires a series of reports to Congress on the Administration's exchange rate policies. Introduced Jan. 6, 1987; referred to Committee on Banking, Finance and Urban Affairs, and Subcommittee on International Finance, Trade and Monetary Policy, which held hearings March 3 and 4 and markup Mar. 17, 1987. The full committee reported Subtitle A (amended) Mar. 25, 1987 (H.Rept. 100, Part 4, Apr. 6, 1987).

H.R. 532 (La Falce)

Competitive Exchange Rate Act of 1987. Identical to H.R. 3, Title IV, Subtitle A, as introduced, except that H.R. 532 omits the provision requiring a Strategic Currency Reserve that is included in H.R. 3. Introduced Jan. 8, 1987; referred to Committee on Banking, Finance and Urban Affairs and Subcommittee on International Finance, Trade and Monetary Policy.

S. 30 (Moynihan)

Exchange Rate Adjustment Act of 1987. Requires intervention in the foreign exchange market to accumulate at least \$30 billion of foreign currencies within three years in a Strategic Currency Reserve. Directs the President to negotiate with countries who tie their currencies to the dollar. Requires computation of exchange rate indexes which accurately reflect changes in the dollar's value. Introduced Jan. 6, 1987; referred to Committee on Banking, Housing and Urban Affairs.

S. 452 (Baucus et al.)

Fair Currency Exchange Rate and Trade Act of 1987. Requires annual reports on exchange rates for each of the 20 foreign countries which have the largest bilateral current account surplus with the United States. Requires negotiations on exchange rate policy with those countries among the twenty who manipulate their currencies. If exchange rate negotiations do not result in currency revaluation, requires negotiations to obtain trade concessions. Introduced Feb. 4, 1987; referred to Committee on Finance.

S. 490 (Bentsen et al.)

Title I, Section 108. Negotiations on Currency Exchange Rates. Requires the President to negotiate with each country that pegs its exchange rates to the dollar to make sure the exchange rate reflects economic fundamentals and to report to Congress on the effects of the negotiations. Introduced Feb. 5, 1987; referred to Committee on Finance, which held hearings Apr. 7, 1987.

CHRONOLOGY

- 04/08/87 --- The finance ministers and central bank governors of the United States, the United Kingdom, France, Germany, Japan, Italy and Canada met in Washington and reaffirmed their Feb. 22 agreement to stabilize exchange rates at current levels.
- 02/22/87 --- The finance ministers and central bank governors of the United States, the United Kingdom, France, Germany, Japan and Canada met in Paris and announced that they would "cooperate closely to foster stability of exchange rates around current levels."
- 01/20/87 --- In a statement on exchange rates, Treasury Secretary Baker and Japanese Finance Minister Miyazawa reaffirmed their commitment to the Oct. 31, 1986 announcement and to coordination of economic policies among major countries.
- 10/31/86 --- Japan announced a reduction from 3-1/2% to 3% in its discount rate in an attempt to stimulate the domestic economy, one of several measures which the United States had been urging Japan to take. At the same time, the United States and Japan jointly announced that the dollar-yen exchange rate is "now broadly consistent with the present underlying fundamentals," implying that the United States would not encourage a further weakening of the yen.
- 05/04-05/06/86 --- The 12th annual economic summit among the heads of state of the U.S., U.K., West Germany, France, Japan, Italy and Canada was held in Tokyo. The participants agreed to form a "Group of Seven" (which would include the Group of 5 plus Canada and Italy), who will work together to improve coordination of international economic policy. The other main economic topics discussed were the international debt problem and the multilateral trading system.
- 03/06-07/86 --- The central banks of Germany, Japan and the U.S. reduced their discount rates, in an apparent coordinated attempt to lower interest rates worldwide.
- 09/22/85 --- The finance ministers and central bank governors of the United States, the United Kingdom, France, Germany, and Japan announced a joint effort to lower the dollar's value. The officials alluded to possible foreign exchange intervention and outlined specific macroeconomic policy actions each country would pursue.

FOR ADDITIONAL READING

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