

MAKING SENSE OF CURRENCY POLICY:
AN HISTORICAL PERSPECTIVE

Remarks by Charles H. Blum, Executive Director
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Part of the folk wisdom of American trade policy is that the Smoot-Hawley tariffs (etched in stone as Column Two in the Tariff Schedule) were the root of all evil. They are widely viewed as a major cause of the widening and deepening of the Great Depression and hence a contributory cause to the second world war. Undoing the prohibitive tariffs that the Congress slapped on the rest of the world in 1930 became the main focus of American trade policy, first through Cordell Hull's reciprocal trade agreements and then through negotiation of the General Agreement on Tariffs and Trade.

There is a lot of truth to the American version of the history of the 1930s. Yet there is more to be learned from what actually happened. It wasn't just a trade war of escalating tariffs and non-tariff restrictions that led to global conflict. At the same time, there was a fierce currency war, a series of competitive devaluations especially in the Pacific region. Currency devaluations trump trade restrictions. Tariffs apply to imports only; currency devaluation affects imports and exports equally and across the board, and it distorts investment decisions as well.

After the war, the GATT became the basic trade contract. The members, referred to as contracting parties, reduced and legally bound their tariffs and banned a range of non-tariff barriers. Over the last 60 years, those rules have been expanded and refined even as the membership has grown to be virtually universal.

On the currency side, however, the progress has been much less impressive. The IMF took a stab at remedying the problem of competitive devaluations through Article 4. It provides, among other things, that IMF members should not use exchange rates to prevent the adjustment of imbalances in trade flows or international payments nor to gain a competitive advantage.

Unfortunately the IMF was given scant powers of enforcement for these sensible objectives. It has rules but no remedy. The IMF can analyze, consult and even on occasion cajole, but it can never compel. Violations of Article 4 simply have no practical consequences for the rule-breaker.

This background helps explain the route the Fair Currency lobby took in search of an effective remedy to the problem of the mercantilist currency practices of China and other countries.. Some of our members raised their concerns about currency

misalignment as far back as 2003, when Rep. Todd Platts wrote a letter on behalf of one his constituents, a major manufacturer in York, PA, asking the new secretary of the treasury, John Snow, to “do something” about the growing problem of outsourcing driven by an attractive currency value. There was some tough talk – even from the President himself -- but no real policy response. In September 2004, the newly formed coalition filed a well documented complaint under Section 301, citing numerous WTO provisions under which undervalued currencies might violate the agreed international rules. By law, USTR has 45 days to consider the merits of a 301 petition. In this case, it took four hours to issue a press release rejecting the petition, and four cabinet officers hurled a series of epithets against us -- reckless, protectionist, and isolationist were among the terms they used.

The very next morning Snow called a group of us into his office, apologized and eventually asked our help in “holding his feet to the fire so that he could hold the Chinese feet to the fire.” He directed us to Under Secretary John Taylor, with whom we met several times. We urged Taylor to pursue a more general realignment – an Asian Plaza Accord, if you will. Taylor told us: “That’s not even on our radar screen.” And sadly it never was.

Taylor’s successor, Tim Adams, tried to engineer some form of coordinated realignment, traveling constantly throughout Asia for several months. Reportedly, he was not backed by Secretary Paulson nor by the White House and resigned without achieving any result.

When Tim Geithner became secretary, we renewed our close contacts with the Treasury and have tried at every turn to strengthen their negotiating position. This is in keeping with our pact made with John Snow.

So, those who say that we should try bilateral and multilateral diplomacy ignore not just the history of the 1930s but also of the last decade. We *have* tried such an approach – meetings of the IMF, the G-20, the G-7, the G-8, the Strategic Economic Dialog and now the Strategic and Economic Dialog. We’ve sent Ben Bernanke to China and brought the Chinese to Capitol Hill. With the support of the Fair Currency Coalition, diplomacy has been tried, and tried, and tried – and it has failed.

In the seven years over which we have supported these diplomatic efforts, our cumulative trade deficit with China amounted to 1.6 trillion dollars. In the same period, China’s official reserves – a good measure of the cumulative imbalance in international payments – rose by 2.1 trillion dollars. These numbers boggle the mind. China’s reserves today exceed the reserves of all the countries in the world – including the oil exports, Japan, the Asian Tigers and every other country – ten years ago,

So, what to do? We turned the countervailing duty law for a few good reasons:

First, currency undervaluation *does* generate a subsidy – a benefit derived from government price-fixing. Injured industries have been entitled to relief from subsidies under US law since the 1890s and under the GATT since the 1940s. We should exercise our legitimate legal right to a remedy from this subsidy, too. The House of Representatives agreed on September 29 by an overwhelming bipartisan vote (348-79).

Second, it is a subsidy that creates a powerful incentive to export rather than deliver the same good into the home market. This is the essence of an export subsidy, a practice that the GATT prohibited from Day One as part of its effort to avoid a repetition of the 1930 trade wars.

Third, as a WTO-consistent remedy, countervailing duties on currency subsidies would have an impact greater than their immediate application. CVD cases have to be pursued on a product-by-product basis, and the products are often defined in extremely narrow terms. One case at a time, though, the message to mercantilist manipulators of currencies would be clear: abandon your mercantilist practice or suffer the consequences on a growing list of exports to the US. CVDs are not an across-the-board measure, but they send an across-the-board message.

Finally, while CVDs can be applied only to imports, they will become useful leverage for a Treasury Department as committed as this one is to bringing about a substantial realignment of all persistently undervalued currencies and to improve the international oversight of exchange rates. This is the ultimate pay-off for all American producers. Enforcement of our CVD law and pursuit of a negotiated solution are complementary, not contradictory, objectives.

So let's not attack HR 2378 for what it isn't or what it doesn't do. It is a modest, targeted, WTO-consistent first step toward a comprehensive overhaul of our currency policy. An overhaul that is badly overdue. An overhaul that, if not accomplished soon, may contribute to a new round of currency wars just as those that deepened the Great Depression. An overhaul that all true free traders should welcome and support.

Thank you very much.