IndustryWeek

The Truth about Trade Deficits and Currency Manipulation

Michael Collins

January 12, 2021

The U.S. Treasury Department has finally determined that China is a currency manipulator, putting currency manipulation and trade deficits back in the news. Trade deficits, currency manipulation and the strong dollar are complicated economic forces that directly affect the future of American manufacturing. Let's look at how they affect manufacturing and why we must face the truth and do something around these issues, regardless of the politics.

Trade Deficits

Let me begin by saying that, yes, trade deficits have and will continue to hurt American manufacturing, although many politicians, economists, and industry associations disagree.

Michael Froman, former trade representative: "Every legitimate economist said that measuring trade policy by the size of the goods deficit is probably not a passing grade in a basic economics class,"

Lawrence H. Summers, Harvard economist: "The trade deficit is a terrible metric for judging economic policy."

Mark Perry, Scholar, American Enterprise Institute: The trade deficit as most people (mis)understand it doesn't even really exist, because America's total trade with the rest of the world is always perfectly balanced once we account for all international transactions for goods, services, investment income, and financial assets."

According to Cato Institute economist Dan Ikenson, "the portion of our trade deficit that needs to be repaid by the American public to foreigners is that portion used to finance government budget deficits—roughly one- fifth the annual trade deficit."

The Bureau of Economic Analysis Table 1 shows that all trade deficits since 1971—the first year the U.S. experienced a trade deficit—total $12.7 trillion. One-fifth of that of that is $2.6 trillion dollars, borrowed over 50 years. This kind of borrowing is not sustainable and makes the economy very vulnerable to future shocks.

Contrary to these economist's statements, trade deficits cannot be ignored. In the book "Unconstitutional," Roger Simmermaker summarizes the problem as "No nation can sustain repeated trade deficits without also suffering a decline in the standard of living, which is what we are now experiencing in the U.S."

It is true that running trade deficits is good for some parts of the economy that depend on cheap imports, but it is undeniable that U.S. manufacturing has been seriously hurt by trade deficits. According to Simmermaker, trade deficits "have played a major role in the hollowing out of our manufacturing industry." He notes that since the year 2000, the U.S. has lost 28% of its manufacturing employment, or about 5.5 million jobs according to BLS 2018 figures. "First, we sacrifice the creation of our wealth, standard of living, tax revenues, and investment capital by transferring our production to other countries and by purchasing excessive quantities of imports," Simmermaker writes. "Then we let foreigners use the same dollars to acquire American assets, (American companies, factories, and land), which is effectively a foreclosed closure process."

Many economists profess that gains in productivity are what caused the loss of manufacturing jobs. Yes, some jobs are lost through automation, but trade and the outsourcing of jobs are the real culprits.

The fact is that ignoring trade deficits indicates that we are willing to sacrifice manufacturing industries so that American consumers can have cheap imported products.

The reality of this debate is that it is true that trade deficits don't matter to Wall Street, or Walmart, or importers, but they really matter to American manufacturing and I will try to explain why and how.

Currency Manipulation

The leading cause of U.S. trade deficits is currency manipulation and misalignment by China and 20 other trading countries. Currency manipulation happens when one of our trading partners buys up U.S. assets such as treasury notes and bonds, which make the value of the dollar artificially high. By making the dollar more expensive, it makes our exports more expensive and makes the foreign countries' products cheaper. Currency manipulation is illegal under the rules of the International Monetary Fund, but the rules are never enforced.

Here is a list of the top 15 countries who manipulate their currencies, and the deficits the U.S. has with each country. They do it because they know it will give their exports a price advantage and they know that the U.S. will do nothing about it. These surplus countries in effect loan us money to pay for our excess of imports over exports, which in effect transfers employment from the U.S. to other countries

Year to date deficits with 15 trading partners as of October 2020

Rank	Country	Deficit ($billions)
1	China	-252.9
2	Mexico	-92.2
3	Vietnam	-56.6
4	Switzerland	-51.1
5	Germany	-46.2
6	Ireland	-46.1
7	Japan	-42.8
8	Malaysia	-25.3
9	Taiwan	-24.1
10	Italy	-22.6
11	Thailand	-21.7
12	India	-19.5
13	Korea, South	-19.3
14	France	-12.1
15	Canada	-11.6
Total as of Oct. 2020		**$749.1 Billon**

Source: U.S. Census Department – Foreign Trade data

The government has known about currency manipulation for decades but no politician—Democrat or Republican—has been willing to face the truth and do something about it.

In 2008, President Barack Obama, in a campaign appearance, said that if China continued its currency manipulation, the U.S. would cut off market access. And when Donald Trump was running for office in 2016, he promised that he would "declare China a currency manipulator" on the first day of his presidency. But when they got into office, nothing happened.

To be fair, I must admit that government has not always ignored the currency manipulation problem. In 1971, Richard Nixon assessed a 10% surcharge that coerced our trading partners to raise the value of their currencies. In 1985, President Reagan forced both Japan and Germany to stop manipulation, which resulted in a 30 % drop in the value of the dollar. But since the 1990s, no administration has done anything about currency manipulation.

One of the reasons that foreign countries are so willing to finance our deficit is that American tax law subsidizes it. The Coalition for a Prosperous America says that other countries invest in

America because they don't have to pay any taxes on the earnings, and as a bonus, "the American government often avoids reporting the income to their home country tax collector."

According to Robert Scott of the Economic Policy Institute, if we could revalue our currency, "the U.S. trade deficit could be reduced by $200 to $500 billion, raising demand for U.S. exports (which are dominated by manufactured goods). Stopping currency manipulation and revaluing the dollar could create 2 to 5 million jobs".

Strong Dollar

Politicians and government administrations are especially afraid to address government policy on the value of the dollar. In 1994, the new treasury secretary of the Clinton administration, Robert Rubin, said, "A strong dollar is in our national interest," because it would assure foreign investors that Washington would not interfere in exchange markets to debase the currency. Rubin, like most treasury secretaries in recent times, was from Wall Street, and Wall Street has more to gain from a strong dollar than any other business or political group.

Since Rubin, every treasury secretary has supported the strong dollar policy. In 2006, Hank Paulson, treasury secretary for George W. Bush, said the benefits of a strong dollar are lower interest rates, more liquid financial markets, cheaper funding for American banks, and the ability to run large trade deficits. In 2010, Treasury Secretary Tim Geithner tabled a report showing that stopping China's currency manipulation would help create one million U.S. jobs. In the Trump Administration, Treasury Secretary Steven Mnuchin admitted that a weak dollar would be good for exports but he didn't label China a currency manipulator until late in 2019.

Everybody knows that the dollar is over-valued, but there is enormous pressure from many business interests to keep it high.

So, at this point you are probably wondering then who benefits from a strong dollar, currency manipulation and the trade deficit?

- First on the list is Wall Street because they get to participate in financing the deficit and selling stocks and bonds to currency manipulators.
- Next, big retailers like Walmart, Costco, Target, Nike and Amazon that import a huge number of cheap products for their retail customers.
- American multi-national Corporations (MNCs) who have manufacturing plants in foreign countries and export back to the U.S.

These are very large and strong lobbying groups that will spend huge amounts of lobbying money to pressure Congress to maintain the status quo and do nothing about the three problems.

But the big loser will be American manufacturing. I think it is undeniable that support of currency manipulation and the strong dollar means sacrificing American manufacturing. If we do nothing about the strong dollar or currency manipulation or the trade deficit then:

1. We will continue to lose manufacturing industries and jobs (36 out of 38 NAISC industries have been declining in terms of employment and plants since 2002).

2. Exports will never exceed value of imports because 70% of exports are manufactured goods.

3. The trade deficit which was $ 729 billion in 2019 will continue to grow. Josh Bivens of the Economic Policy Institute found that in 2011" the cost of imbalanced trade with low wage countries cost workers without college degrees 5.5% of their annual earnings (about $1,800)". These workers represent 2/3 of the American workforce.

4. The GDP growth of the economy will stay around 2%

President-elect Biden's incoming administration intends to "mobilize American manufacturing and innovation to ensure that the future is made in America," according to Biden's transition website. In recent speeches, Biden also says he" plans to build a strong industrial base and small-business-led supply chains to retain and create millions of good-paying union jobs in manufacturing and technology."

To accomplish any of these goals, Biden will have to actually do something about the trade deficit, currency manipulation and the strong dollar. A voluntary solution has been tried for decades, but quite negotiation doesn't work because the countries know the U.S. will not enforce any agreements. Countervailing currency intervention—buying corresponding amounts of a foreign country's currency to make their currency rise in value—will not work because China and other countries block any purchase of their currency.

Other approaches include:

Countervailing duties (CVDs): These are tariffs or taxes on imported goods that offset subsidies by our various trading partners. CVDs could be in the form of a surcharge, tax, or tariff. Even though tariffs have hurt some importers, Jeff Ferry of CPA offered proof that they have really helped U.S. manufacturing.

Taxing purchases: Using a market access charge for all foreign investors buying U.S. assets would begin to lower the value of the dollar to a trade balancing price

Withholding taxes on the profits and dividends earned by foreign investors that finance the dollar.

Developing manufacturing strategy: American manufacturing needs a strategy that sets measurable objectives for reducing the trade deficit and stopping currency manipulation. A bill to develop a manufacturing strategy, sponsored by former U.S. Rep. Dan Lipinski (D), even passed the house but died in the Senate in 2010.

Taxing sellbacks: Biden has proposed a 30% tax on the profits of companies that have offshored their production while selling products back to the U.S**.**

We are currently in an unsustainable game we cannot win, as long as we allow our trading partners to make us play on an uneven and unfair field.

The time has come for strong enforcement and real penalties.

The U.S. has nothing to fear from getting tough. We have tremendous leverage because all of these manipulating countries are export-dependent, and we have the biggest consumer market in the world that everyone wants to sell to. They need us more than we need them.

The inconvenient truth is that we will never be able to grow our exports and stop the slow erosion of manufacturing as long as we allow currency manipulation and the dollar to be artificially inflated. Please tell me what you think about these issues.