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No currency manipulation rules in Pacific trade deals a good thing for Americans

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Last week, President Obama told Congressional Democrats not to expect any rules against "currency manipulation" in the forthcoming Trans-Pacific Partnership (TPP) trade deal. This is bad news for protectionists — of both left and right — but is very good news for American consumers and workers.

Some Congressional Democrats, like Rep. Sander Levin, D.-Mich., blame job losses in American manufacturing on China's deliberate undervaluation of its currency, the Remnimbi. Rep. Levin plans to introduce a bill aimed at currency manipulation.

Democrats aren't alone in this. Sen. Lindsay Graham, R-S.C., a potential 2016 Republican presidential candidate, told The Hill, "I believe there is bipartisan opposition to any trade agreement that doesn't deal with currency." With such bipartisan hostility toward currency manipulation, it must be a very bad thing, right?

Wrong! Contrary to popular belief, currency manipulation by exporting countries like China and Japan brings net benefits to the U.S. The argument that some currencies are undervalued, and therefore goods produced in those countries undercut American goods, is often cited as justification for protectionist measures against foreign competitors. It seems intuitive, but it's not that simple.

To begin with, if a given country decides to drive down the value of its currency to boost exports, it represents a subsidy to Americans paid by the other country's citizens. That benefits not only American consumers, but also importing producers, because a significant amount of trade consists of intermediate goods — semi-finished products like car engines or commodities like sugar used to make candy. China's role in the global supply chain, where it often provides such intermediate goods, means its monetary policy doesn't always affect the price of final consumer products.

Members of Congress and lobby groups, including the auto and steel industries, claim that currency manipulation gives an unfair advantage to foreign producers and discriminates against the U.S. exporters, creating trade deficits and job losses, especially in manufacturing. Though it is true that employment in exporting sectors might decline, this does not mean that U.S. is losing jobs on net.

Higher imports release resources, including labor, that can be used to produce other goods that otherwise would not be locally available. Moreover, the figures show that foreign investment in the U.S. exceeds capital outflows, also creating economic activity and jobs.

In short, while the visible direct effects of currency manipulation may seem negative to Americans, the unseen effects are all positive. More affordable consumer goods and increased economic opportunity result in benefits to America as a whole. If China were to end its experiment overnight, even without political pressure, Americans would suffer, and less well-off Americans would suffer the most.

Some lawmakers want to include provisions in the TPP and other trade agreements to address currency manipulation. Yet, there is no general agreement on the true value of a certain currency, which makes it impossible to create provisions that would not result in further market distortions. Currency provisions in trade agreements would hinder foreign direct investment inflows into the U.S. and harm consumers and businesses that would end up paying higher prices.

Moreover, the U.S. already has trade remedy laws, which as the Cato Institute's Daniel R. Pearson points out are preferable to currency manipulation provisions, as they do not apply to all imports from the supposedly offending country.

Finally, other countries will oppose currency provisions as biased towards the U.S. The U.S. dollar is the world's primary reserve currency, so the country does not need to accumulate reserves. Therefore, penalizing other countries for accumulating dollar reserves would likely prove a deal-breaker in trade negotiations. (And it could be argued that the Federal Reserve's quantitative easing policy is itself a form of currency manipulation).

For these reasons, the absence of currency manipulation rules in the proposed deal is welcome. If the trade agreement implicitly rules out populist retaliation against foreign currencies that are viewed as deliberately undervalued, so much the better.