Testimony of Thea Mei Lee
Policy Director
American Federation of Labor and Congress of Industrial Organizations

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Ways and Means Subcommittee on Trade;
Financial Services Subcommittee on
Domestic and International Monetary Policy, Trade, and Technology;
and the Energy and Commerce Subcommittee on
Commerce, Trade and Consumer Protection.

On

"Currency Manipulation
and Its Effect on U.S. Businesses and Workers"

May 9, 2007

Chairman Levin, Chairman Gutierrez, Chairman Rush, Members and Ranking Members of all three Subcommittees, I am delighted to have the opportunity to testify today on behalf of the ten million working men and women of the AFL-CIO. My remarks on currency manipulation are also offered on behalf of the China Currency Coalition, of which the AFL-CIO is a founding member.

Currency manipulation is an urgent economic issue for American workers and businesses. We all live and work and compete in the global economy – but in order to succeed in the global economy, we need our own government to ensure that the terms of competition are fair. Defining -- and adequately addressing -- currency manipulation is an essential element of ensuring fair global competition, but the institutions of the global economy and our own government have so far failed to rise to this challenge.

The AFL-CIO is working closely with our allies in the domestic manufacturing sector, as well as with many American farmers and ranchers, to draw attention to the job, wage, and community impacts of currency misalignments and to urge effective solutions.

Unfortunately, it often appears that this Administration does not share our sense of urgency. We hope that Congress will step into the void left by the Administration's failure to act, and we welcome this hearing as a crucial step in that direction.

The Economic Importance of Addressing Currency Manipulation

The economic impact of currency manipulation is equivalent to a country's raising tariffs on imports or subsidizing its exports. Currency manipulation shifts the relative prices of imports and exports through deliberate government action, creating a competitive advantage for the country that keeps its currency undervalued.

As a nation, we put tremendous energy into negotiating international trade rules to expand reciprocal market access at the World Trade Organization and through bilateral and regional trade agreements. Yet, small tariff changes can – and have been – swamped by unanticipated currency movements that effectively nullify negotiated changes in tariffs and disciplines on export subsidies.

In principle, rules are in place at both the World Trade Organization (WTO) and the International Monetary Fund (IMF) to prevent countries from gaining an unfair competitive advantage through exchange rate action. Yet neither the WTO nor the IMF, nor our own government, appears willing or able to implement these provisions.

Our government needs to realign its priorities and reevaluate its policy tools to recognize and address this problem.

Defining the Problem

This Administration has failed even to correctly identify currency manipulation as a problem and has failed to hold governments accountable for their actions.

In December, the Treasury Department issued its 2006 Report to Congress, in which it found that "no major trading partner of the United States met the technical requirements for designation [as a currency manipulator] under the terms of Section 3004 of the [Omnibus Trade and Competitiveness] Act [of 1988] during the period under consideration." The 2007 Report, which was due on April 15th, has not yet been submitted to Congress.

The relevant portion of the 1988 Act states that: "The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

The 2006 Treasury report finds that China's current account surplus rose to "around 8 percent of GDP" in the first half of 2006, up more than fivefold from 2001. It also notes that China's foreign exchange reserves "reached $1 trillion in October," adding around $200 billion in reserves just in the last twelve months.

The Chinese government has intervened massively in foreign exchange markets in order to prevent the RMB from appreciating. According to Fred Bergsten's January 31, 2007 testimony to the Senate Banking Committee, the Chinese government has bought $15-20 billion worth of foreign exchange every month for several years in order to keep the value of its currency down.

The U.S. trade deficit with China hit $232.5 billion in 2006, up about 15 percent since last year. This is 28% of our total goods deficit, but a startling 43% of our non-petroleum goods deficit. The Economic Policy Institute has estimated that the growing bilateral deficit with China has displaced 1.8 million jobs since China joined the WTO in 2001.[1] Jobs were displaced in every state and the District of Columbia.

Japan has also intervened extensively in currency markets – spending more than $400 billion between 2000 and 2004 to push down the value of the yen against the dollar. In 2006, Japan ran an $88 billion surplus with the United States in 2006 -- $56 billion of that total accounted for by automobiles and parts. The U.S. Automotive Trade Policy Council estimates that the yen is undervalued by at least 20 to 25 percent against the dollar, giving every imported Japanese car a $4000 cost advantage over U.S.-made cars.

Either there is something wrong with the criteria Treasury is using to determine currency manipulation, or there is something wrong with the Treasury Department's math.

In a recent Policy Memorandum, economists Josh Bivens and Rob Scott of the Economic Policy Institute laid out three clear criteria for determining whether or not a country is manipulating its currency: "First, does it have a high and rising bilateral trade surplus with the United States? Second, is its *global* current account surplus (the broadest measure of its trade and income flows) high and rising? Third, does it possess a high and rising accumulation of international reserves?" [2] Certainly, both China and Japan meet all these criteria.

Table 1 below (reprinted from EPI) compares China's current position to nine past instances when the Treasury Department found that nations were manipulating the value of their currency vis-à-vis the dollar for competitive gain. "On each front," write Bivens and Scott, "the current position of China well exceeds the previous threshold that led to a finding of manipulation."

Many respected academic experts have also weighed in on this issue. The bipartisan, Congressionally appointed U.S.-China Economic and Security Review Commission (USCC), in its 2006 report, found that China's currency manipulation "harms American competitiveness and is also a factor encouraging the relocation of U.S. manufacturing overseas while discouraging investments in U.S. exporting industries." The Commission also found that the currency manipulation "distorts the trading relationship between the United States and China. … American small and medium-size enterprises are particularly disadvantaged by having to compete for U.S. market share with Chinese exporters who enjoy the subsidy of an artificially undervalued renminbi."[3]

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[1] Robert E. Scott, "Costly Trade with China: Millions of U.S. Jobs Displaced with Net Job Loss in Every State," Economic Policy Institute Briefing Paper #188, May 2, 2007.

[2] *L. Josh Bivens* and *Robert E. Scott*, "**China Manipulates Its Currency—A Response is Needed.**" Economic Policy Institute Policy Memorandum #116, September 25, 2006.

[3] U.S.-China Economic and Security Review Commission, "2006 Report to Congress," November 2006, pp. 6, 53. Report is available at: http://www.uscc.gov/annual_report/2006/06_annual_report.php .

Table 1. Currency manipulation found nine times in the past

		Trade surplus w/ U.S. annual rate (US$ billions)	GDP	Trade surplus w/ U.S. annual rate (% of GDP)	Global Current Account most recent year (US$ billions)	Global Current Account most recent year (% GDP)	Accumulation of reserves 12-month change (US$ Billions)	Accumulation of reserves Total reserves (Months of imports)
Taiwan	Oct-88	17.4	97.8	17.8%	18.1	18.5%	31	28.0
	Apr-89	13.9	122.9	11.3%	10.2	8.3%	-	-
	May-92	9.8	179.1	5.5%	12.0	6.7%	14	17.0
	Dec-92	10.5	179.1	5.9%	12.0	6.7%	13	18.0
South Korea	Oct-88	9.4	120.5	7.8%	**10.0**	8.3%	7	-
	Apr-89	9.0	157.1	5.7%	14.3	9.1%	9	**3.0**
	Oct-89	**8.1**	169.0	4.8%	14.2	8.4%	9	-
China	May-92	12.7	369.7	3.4%	12.2	**3.3%**	14	10.0
	Dec-92	16.7	409.1	4.1%	13.5	3.3%	**6**	8.0
Current position of China								
China		203.8	2,259.2	9.0%	160.8	7.1%	207	12.9

Bold indicates lowest level with finding of manipulation.

Historical data source: U.S. Treasury Report to the Congress on International Economic and Exchange Rate Policy.
Current data source: U.S. International Trade Commission and the International Financial Statistics Database of the International Monetary Fund.

Ben Bernanke, Chairman of the Federal Reserve Board, in his prepared remarks to the Chinese Academy of Social Sciences, dated December 15, 2006, wrote that China's undervalued currency provides an "effective subsidy . . . for Chinese firms that focus on exporting rather than producing for the domestic market." He outlined some of the advantages for China of allowing the RMB to appreciate, including encouraging a shift toward domestic consumption and social services, as well as improving long-term financial stability.

China's currency manipulation also impacts other trading partners, who feel pressured to keep their currencies competitive with the RMB in order to avoid a competitive disadvantage in the U.S. market. Bivens and Scott write, "There is a cost to developing nations from the Chinese currency peg. By pursuing mercantilist exchange rate policies, China has robbed market share from smaller developing countries and forced many into managing their own exchange rates with the goal of matching China's competitive position. Many of them would prefer a more flexible currency regime but cannot allow themselves to get priced out of competitiveness in the U.S. market through China's manipulation."[4]

Exactly what would it take for Treasury to find that a country had in fact manipulated its currency, and – perhaps more important – what it would take to move beyond yet another round of endless diplomacy and strategic dialogue to concrete action and results?

[4] *L. Josh Bivens* and *Robert E. Scott*, "**China Manipulates Its Currency—A Response is Needed.**" Economic Policy Institute Policy Memorandum #116, September 25, 2006.

This is not an academic exercise for the union members we represent. The difference between currency manipulation and a market-equilibrium exchange rate is the difference between having a job and watching your factory shut its gates. It is the difference between having health insurance for your kids – or not. And, for our country, it may be the difference between having a healthy middle class – or sitting back and watching as economic divisions tear us apart.

And, tearing us apart they are. The fact is domestic manufacturers and their workers are forced to compete at an enormous competitive disadvantage from manipulated currency rates – even before taking into account all the other issues we face: violations of workers' rights, asymmetrical tax policies, illegal subsidies, lax environmental and resource regulations, and a dysfunctional health care and pension system that disadvantages our manufacturers.

Failure to Act

In June 2005, then-Secretary Snow testified to the Senate Finance Committee that "if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation … Concerns of competitiveness with China also constrain neighboring economies in their adoption of more flexible exchange policies. China's rigid currency regime has become highly distortionary."

Given the raw economic data on trade imbalances and reserve accumulation, it certainly appears that current trends have not only "continued without substantial alteration," they have accelerated.

Therefore, we were bitterly disappointed that Treasury found no manipulation again this year, and we were underwhelmed by the announcement of the "Strategic Economic Dialogue" (SED) as a response to the "global imbalances" that the report did concede.

On paper, the SED promises a "forum for addressing critical economic issues and planning for long-term cooperation." Issues to be addressed include developing efficient innovative service sectors, health care, cooperation on transparency issues, and a joint economic study on energy and environment, among other things.

This SED offers too little, too late. The proposed forum, dialogue, and cooperation are grossly inadequate, given the magnitude of the economic problems we face with respect to China. Beyond its limitations with respect to currency manipulation, the SED does not even begin to address a separate and equally serious economic concern: the egregious and widespread repression of workers' rights in China. The breadth of the SED needs to be expanded, as does its core content.

Neglect of Workers' Rights

We continue to be frustrated that this Administration fails to raise the issue of workers' rights violations with the Chinese government in any effective or high-level forum. None of the highest-level economic dialogues with the Chinese government include workers' rights as part of their public agenda (neither the Joint Commission on Commerce and Trade, nor the SED, address the issue publicly).

Violation of workers' rights is just as much an economic issue as currency manipulation, violation of intellectual property rights, or illegal subsidies. We estimate that hundreds of thousands of U.S. jobs are lost because the Chinese government brutally suppresses the rights of Chinese workers to form independent unions and bargain collectively for their fair share of the wealth they create.[5]

Promoters of permanent normal trade relations (PNTR) and China's accession to the WTO argued that unfettered trade and investment would be the best way to raise living standards and promote human rights in China.

Unfortunately, the five years since China's accession to the WTO have not borne out this prediction. Instead, increased trade and investment have coincided with continued harsh violations of workers' rights, rising worker unrest, and a "strike hard" campaign against dissent by the Chinese government. Far from "exporting American values" to China, American companies have been complicit in this abuse and have profited from it.

Legal protections for wages, benefits, and hours are routinely violated in the private sector, and shoddy enforcement of health and safety standards costs workers' lives in China's export industries.

Faced with growing worker unrest, the Chinese government continues to choose violence and repression as tools of control, and has made only cosmetic gestures towards legal reform. Proposed reforms to China's trade union law in 2001, while ostensibly designed to protect union organizing in the growing private sector and strengthen workers' rights, maintain the single government-controlled labor organization's strict legal monopoly over all trade union activity in China. Yet American business interests resisted even those modest reforms, weighing in against measures that might strengthen workers' rights at the margin. (See the excellent report by Global Labor Strategies, "Undue Influence: Corporations Gain Ground in Battle Over China's New Labor Law," available at www.laborstrategies.org .)

We are baffled and frustrated at our own government's failure to insist that the Chinese government honor its international obligations as a member of the International Labor Organization and the United Nations. The Congress has given the executive branch numerous tools to provide leverage in this area, including Section 301, which explicitly defines egregious violation of workers' rights as an unfair trade practice. Yet the Administration refuses to apply these tools.

Time for Action

In 2004, the AFL-CIO, along with a group representing several dozen U.S. industrial, service, agricultural, and labor organizations, formed the China Currency Coalition. On

[5] See the Section 301 petition filed by the AFL-CIO in June 2006: http://www.aflcio.org/issues/jobseconomy/globaleconomy/chinapetition.cfm .

September 9, 2004, the Coalition filed a Section 301 petition alleging that China's currency manipulation was an unfair trade practice under U.S. trade law.

The petition laid out China's international obligations under World Trade Organization (WTO) and International Monetary Fund (IMF) rules and documented the extent of the manipulation, as well as its impact on American workers and businesses. Finally, the petition asked the Bush Administration to "seek authorization in the WTO through expedited dispute settlement" to offset the subsidy and take measures to offset the disadvantage caused by the currency manipulation for U.S. exports to China.

The Bush Administration summarily rejected the petition within a few hours of its filing – apparently without taking the time to read the several hundred pages of analysis, documentation, statistics, and tables. (I commend the full petition to you: it can be downloaded, along with its supporting materials, at:
http://www.chinacurrencycoalition.org/petition.html .)

A bipartisan group of 35 U.S. Senators and Representatives refiled the petition on April 20, 2005, only to have it rejected again.

The Bush Administration never challenged the factual findings of the petition, only claimed that dialogue and engagement with China would be more effective than accepting the petition.

Then-Treasury Secretary John Snow said in a press conference held earlier in the year: "China acknowledges [that it is best for the global system, for the United States, and for China to move to a flexible exchange regime] and is making progress toward this goal." He boasted of the "extensive" talks under way: "I have held extensive meetings and consultations with the Chinese economic team both here in Washington and in Beijing." And he touted the progress being achieved: "With steady progress clearly being made, the most effective way at this time to achieve the goal of a flexible, market-based exchange rate in China is to maintain the *persistent engagement* we have established rather than through a trade petition" (emphasis added).

Then-USTR Robert Zoellick promised strategic leverage would be used to pressure China: "America's policy of leveraged engagement gives us constructive new ways to press for real results in China…. Under U.S. law, the first two criteria that China must meet to be considered as a 'market economy' are: the extent to which the currency of China is convertible; and the extent to which wage rates in the foreign country are determined by free bargaining between labor and management…. *These statutory criteria, together with China's strong interest in being recognized as a market economy under U.S. laws, provide us with significant leverage on labor, currency, subsidy and other issues, and we plan to use it"* (emphasis added).

John B. Taylor, at the time Under Secretary for International Affairs at Treasury, quoted President Bush in a speech on October 21, 2004: "As President Bush recently said, ... "So I'm saying to places like China, you treat us the way we treat you. You open up your markets just like we open up our markets. And I say that with confidence because we can compete with anybody, any time, anywhere so long as the rules are fair."

So many promises, so few results.

The Bush administration has refused to hold the Chinese government to its international obligations on trade, currency manipulation and human rights, and has denied American businesses import relief they are entitled to under the law. The administration has actively encouraged the Japanese government, as the yen has remained seriously undervalued.

The AFL-CIO believes that the Bush Administration needs to move beyond "bilateral consultation" and continued dialogue to address the urgent problems in the U.S.-China and U.S.-Japan trade and economic relationships.

First, the Administration should use the annual Treasury Department exercise to send a clear and consistent message to the governments of both China and Japan that they have been identified as currency manipulators and that concrete actions will follow if needed adjustments are not made in a timely fashion.

Second, the Administration should signal that it will initiate WTO dispute resolution with respect to ongoing currency manipulation.

But Congress cannot wait for this Administration to act.

We urge Congress to give immediate consideration to the Fair Currency Act of 2007, H.R. 782.

This bill clarifies the definition of currency manipulation, identifies currency manipulation as an illegal subsidy, and ensures that countervailing duty laws can be applied to non-market economies. It applies to any country that is manipulating its currency. It is a crucial first step in addressing the urgent economic problems we face today.

I thank the three Subcommittees for the invitation to appear here today, and I look forward to your questions.