

**BEFORE THE SUBCOMMITTEE ON ECONOMIC POLICY  
U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS**

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**STATEMENT OF CHARLES H. BLUM  
FAIR CURRENCY COALITION**

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**HEARING REGARDING  
CHINA'S EXCHANGE RATE POLICY AND TRADE IMBALANCES  
(April 22, 2010)**

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On behalf of the members of the Fair Currency Coalition (FCC),<sup>1</sup> I thank the Subcommittee for this opportunity to testify on what action the United States can and should take to remedy the persistent problem of currency undervaluation by China and other countries. The FCC and its antecedents have worked on this problem continuously for seven years. In 2003-4, we developed a well researched and argued petition filed under Section 301 of the Trade Act of 1974 that was summarily rejected by the last administration.

Only then did we turn to a legislative solution, developing and refining the legislation currently known as the Currency Reform for Fair Trade Act, introduced by Senators Stabenow and Bunning in the Senate (S. 1027) and by Reps. Tim Ryan and Tim Murphy in the House (H.R. 2378).<sup>2</sup> We will continue to work on this problem until it has been resolved on an effective and lasting basis.

**A Remedy Delayed is a Remedy Denied**

Currency misalignment is not a new problem, nor is it limited to the Chinese renminbi (RMB). On the contrary, it is a perennial problem for reasons that we will address in this testimony and one that continues to grow in severity.

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<sup>1</sup> See Attachment 1 for the FCC's list of members.

<sup>2</sup> As of April 20, 2010, S. 1027 has eight cosponsors, and H.R. 2378 has 102 cosponsors.

Consider the data contained in Attachment 2. They show that over the ten years since China's accession to the World Trade Organization (WTO), the U.S. trade deficit with China has mushroomed, as have China's global trade surplus and its stockpile of official foreign exchange reserves. At the same time, US manufacturing employment has plummeted by one-third.

We do not suggest that the undervalued RMB is the sole cause of the loss of American manufacturing jobs, though the two clearly are related. Our point is simply that the long delay in our response to this persistent problem has allowed it to grow to the detriment of American workers and industries. Moreover, what would have been a more easily managed problem -- had we acted on the Section 301 complaint in 2004, the first version of our legislation in 2005, the improved version in 2007, or even the latest version introduced last year -- has become an enormous problem.

A remedy delayed is a remedy denied. The longer it is denied, the greater the injustice. History suggests that the currency problem will become even larger and harder to manage in the future unless we act now.

Let's look at the options for near-term solutions.

### **Multilateral Rules Provide No Solution to Currency Misalignment**

For understandable reasons, many would prefer to find a solution in the multilateral rules and institutions that are supposed to provide a framework for settling monetary disputes among nations. Indeed, repeated attempts have been made to address the problem through these channels. By now it should be clear that existing multilateral rules and institutions are woefully inadequate to deal with the problem of currency misalignment *per se*. The problem lies not in the degree of effort by our government but rather in the weakness and imprecision of the rules themselves and the excessive length of multilateral dispute resolution processes.

Consider the following the sorry performance of the International Monetary Fund:

- International Monetary Fund Article IV – the most relevant international law on exchange rate practices -- obligates members to “avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.”<sup>3</sup> The overriding aim of Article IV is “sound economic growth” and the correction of imbalances that threaten it.
- As part of its exchange rate surveillance mandate, the IMF holds annual consultations with each of its members under Article IV. Repeatedly, the IMF has in careful, diplomatic language suggested that China should revalue the renminbi. Such moral suasion is the only tool the IMF has, and it has never been enough to persuade China to end its mercantilist currency policy. Indeed, China has taken the extraordinary step of blocking the release of the IMF’s reports for 2007, 2008 and 2009, presumably because it does not like the conclusions.
- The weakness of its rules and the lack of any credible enforcement power makes the IMF useless for all practical purposes in addressing the problem of currency misalignment.

Consider next the problem of addressing currency misalignment through the rules of the World Trade Organization:

- Article XV provides that WTO members “shall not, by exchange action, frustrate the intent of the provisions of this Agreement nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.”<sup>4</sup>
- Such broad language might conceivably form the basis for action under WTO rules. A legal argument clearly exists that undervalued misalignment of a currency constitutes an export subsidy, a practice prohibited on manufactured goods by GATT Article VI. In addition, it can be argued that undervaluation constitutes a *de facto* additional levy on imports, nullifying and impairing the tariff bindings under GATT Article II. Indeed, such allegations were among those made by the Coalition’s Section 301 complaint in 2004, and we continue to believe that they have legal and economic merit.

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<sup>3</sup> IMF, Article IV, Section (1)

<sup>4</sup> General Agreement on Tariffs and Trade, Article XV, Section 4.

- While there is little question that an undervalued currency has those deleterious effects on key elements of the basic trade contract among WTO members, it is far less clear what action the WTO might take in response to a complaint brought by the United States or a group of countries.
- Novel issues pose substantial problems for the WTO's *ad hoc* dispute settlement panels and the standing Appellate Body. Panelists are drawn from the trade policy establishment around the world. Their knowledge and experience vary, of course, but few of them have any grounding in monetary affairs. As a consequence, it is difficult to anticipate how they would analyze, much less resolve, disputes centering on IMF standards and concepts.
- Most importantly, the WTO arguably lacks a clear mandate to deal with these issues on its own. Instead, GATT Article XV, paragraph 2 requires the WTO to "consult fully with the International Monetary Fund" in cases dealing with "monetary reserves, balances of payments or foreign exchange arrangements." Worse yet, the WTO is obligated by that same paragraph of Art. XV to "accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund."
- Thus, the WTO must rely on the impotent IMF to decide the issue, that same IMF that can't even find a way to convince the Chinese to agree to the release of three annual consultation reports that have no legal or practical consequences.
- In addition, the filing of a case by the U.S. government under the WTO has other potential pitfalls. First, as the plaintiff in the case, the burden of proof would be on the United States to prove that action on currency manipulation falls within the ambit of WTO rules. Thus, the United States would be forced to meet a higher evidentiary threshold than the defending country, likely China. Second, the adjudication and remedy implementation process of WTO appellate panels is painfully slow. Not only is the outcome difficult to predict, it will take years to render and implement any decision – time American producers facing subsidized import competition do not have.

This brief analysis helps explain why chances of any timely solution arising from the existing rules on currency manipulation or misalignment are for all practical purposes zero.

### **Multilateral Rules Cannot Be Upgraded in the Foreseeable Future**

Others have proposed that the solution lies in updating the existing multilateral rules to render them relevant to the realities of this century rather than the last. The most direct approach is that proposed by Arvind Subramanian of the Peterson Institute for International Economics and Aaditya Mattoo of the World Bank. They suggest that WTO rules be amended so as to prohibit currency undervaluation. They choose the WTO over the IMF because undervaluation has clear trade effects and because the IMF has no enforcement powers, especially when it comes to large creditor nations – just the ones who might benefit most from an undervalued currency.

Theoretically, this concept seems direct and sensible. As a practical matter, however, there is little chance whatsoever that the WTO could be amended this way and no chance at all that it could be done expeditiously.

For the foreseeable future, we are stuck with the multilateral rules as they are in dealing with this urgent and still growing problem.

### **Trade Remedies Are the Only Effective Tool for Addressing Currency Misalignment**

Thus, by a process of elimination, we come to national trade laws as the only basis for effective legal action to counter currency misalignment. The FCC has long believed that the most effective, readily available tool is the countervailing duty law, the means authorized by WTO rules for any member to neutralize injurious subsidies.

Under U.S. law and the WTO rules, there are three requirements for a determination of subsidy: 1) a financial contribution by or at the direction of the foreign government that 2) confers a benefit upon the recipient and that 3) is not generally available. In the case of undervalued currencies, the government-established rate – price fixing on a broad scale – forces banks to pay to the seller of an internationally traded good or service extra units of the home currency compared to the fair market value of the currency. The extra units of currency constitute the

benefit. That benefit creates an incentive to export. Currency undervaluation thus seems to be a classic example of an export subsidy. Under GATT rules, export subsidies have been prohibited since the 1940s because they are inherently distortive of trade flows. Implementing the multilateral rules through the US countervailing duty law thus seems to be a reasonable reliance on established international law.

In our opinion, the Department of Commerce already has the authority to investigate currency subsidies.<sup>5</sup> Determining it to be an export subsidy would seem to comport well with established Commerce practice and US law. Until now, the Department has not agreed, although its position seems to have shifted at least once. That suggests that the Department would benefit from passage of legislation that clarified the status of currency subsidies under the countervailing duty law by distinguishing actionable from non-actionable forms. The Department would also benefit from clarity regarding the method of calculating the subsidy, the source of data to be used in that calculation, and other procedural matters.

The clear expression of Congressional intent would facilitate the application of existing law to a new area of economic activity, reduce the scope for controversy, strengthen the hand of the government in the litigation that inevitably will follow, and provide helpful guidance to trade practitioners – importers, exporters and foreign governments – about the rules that will govern their trade.

Recently, another significant legislative proposal emerged in the Senate, the Currency Exchange Rate Oversight Act of 2010 (S. 3134). The chairman of this subcommittee and Senator Graham are among the 18 cosponsors. The bill seeks to update the Treasury Department's oversight of foreign government currency practices. An important part of the bill is the attempt to provide Treasury with credible negotiating leverage by authorizing the use of trade law remedies in response to currency undervaluation. The FCC welcomes this legislation. We have concerns

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<sup>5</sup> This opinion is shared by the 130 members of the House of Representatives who signed a letter to Commerce Secretary Gary Locke and Treasury Secretary Timothy Geithner dated March 15, 2010. Fifteen members of the Senate wrote to Secretary Locke on February 26, 2010, arguing that Commerce had sufficient authority under existing law to initiate a full investigation of alleged currency subsidies. Both documents are available at <http://www.faircurrency.org>.

about some of the current provisions, especially as they relate to countervailing duty remedies, and are working with the chief cosponsors, Senators Schumer and Stabenow, to strengthen them as much as possible. We do so in the firm belief that countervailing duties are the best available remedy to currency undervaluation.

### **Responsible Use of Trade Remedies is Not Protectionism But Supports Free Trade**

In closing, let me deal with the standard argument that any use of our trade laws is inherently protectionist. No less a free trader than Ronald Reagan explained his trade policy in a radio address to the nation in the summer of 1986. Coincidentally, he did so shortly after the Plaza Accord led to a substantial realignment of major currencies.

Reagan made three points: first, trade must be reciprocal -- “Free and fair trade with free and fair traders” was his motto; second, trade must be based on a respect for the rules; and third, trade policy must produce results.

Reciprocity. Respect for rules. Results. Those are three touchstones that should continue to guide U.S. trade and currency policy.

As Martin Wolf wrote recently in the Financial Times, “The U.S. was right to give talking a chance. But talk must lead to action.” Legislation is the right thing to do. It is the only thing we can do. It is the one thing we must do. It’s high time for the Congress to act by passing S. 1027.

**FAIR CURRENCY COALITION: MEMBERS  
(As of February 19, 2009)**

1. Allegheny Technologies Incorporated
2. American Corn Growers Association (ACGA)
3. American Cotton Shippers Association
4. American Federation of Labor Industrial Union Council
5. American Foundry Society
6. American Iron and Steel Institute
7. American Manufacturing Trade Action Coalition
8. American Mold Builders Association
9. Bakery, Confectionary, Tobacco Workers and Grain Millers International Union (BCTGM)
10. Coalition for a Prosperous America
11. Communication Workers of America (CWA)
12. F & L Metal Finishes, Inc.
13. The Copper & Brass Fabricators Council, Inc.
14. International Association of Machinists and Aerospace Workers (IAM)
15. International Brotherhood of Boilermakers (IBB)
16. International Brotherhood of Electrical Workers (IBEW)
17. International Federation of Professional Employees (IFPTE)
18. Lapham-Hickey Steel Corporation
19. Manufacturers Association of Central New York (MACNY)
20. Metals Service Center Institute
21. National Council of Textile Organizations
22. National Textile Association
23. National Tooling and Machining Association
24. North American Die Casting Association
25. Nucor Corporation
26. Organization for Competitive Markets
27. Penn United Technologies, Inc.
28. Precision Machined Products Association
29. Precision Metalforming Association
30. Sheet Metal Workers International Association (SMWIA)
31. Specialty Steel Industry of North America
32. Spring Manufacturers Institute
33. Steel Dynamics, Inc.
34. Steel Manufacturers Association
35. Tooling & Manufacturing Association
36. Tooling, Manufacturing, and Technologies Association
37. United Automobile Workers (UAW)
38. Universal Electric Corporation
39. United Mineworkers of America (UMWA)
40. United States Business & Industry Council
41. United Steelworkers of America (USW)
42. US Industrial Fabrics Institute
43. Wisconsin Paper Council
44. Wood Machinery Manufacturers of America (WMMA)
45. Vanadium Producers & Reclaimers Association
46. Xcel Mold and Machine, Inc.



**Impact of Inaction on the China Currency Problem:  
Key Indicators (Billions of USD)**

|             | <b>U.S. Trade<br/>Deficits with<br/>China<sup>1</sup></b> | <b>China Trade<br/>Surplus with the<br/>World<sup>2</sup></b> | <b>China Foreign<br/>Exchange<br/>Reserves<sup>3</sup></b> | <b>U.S.<br/>Manufacturing<br/>Employment<br/>(Millions)<sup>4</sup></b> |
|-------------|-----------------------------------------------------------|---------------------------------------------------------------|------------------------------------------------------------|-------------------------------------------------------------------------|
| <b>2000</b> | 83.83                                                     | 24.11                                                         | 165.57                                                     | 17.18                                                                   |
| <b>2001</b> | 83.10                                                     | 22.55                                                         | 212.17                                                     | 15.71                                                                   |
| <b>2002</b> | 103.06                                                    | 30.43                                                         | 286.41                                                     | 14.91                                                                   |
| <b>2003</b> | 124.07                                                    | 25.47                                                         | 403.25                                                     | 14.30                                                                   |
| <b>2004</b> | 162.25                                                    | 32.09                                                         | 609.93                                                     | 14.29                                                                   |
| <b>2005</b> | 202.28                                                    | 102.00                                                        | 818.87                                                     | 14.19                                                                   |
| <b>2006</b> | 234.10                                                    | 177.48                                                        | 1,066.34                                                   | 14.00                                                                   |
| <b>2007</b> | 258.51                                                    | 262.20                                                        | 1,528.25                                                   | 13.73                                                                   |
| <b>2008</b> | 268.04                                                    | 295.46                                                        | 1,946.03                                                   | 12.82                                                                   |
| <b>2009</b> | 226.83                                                    | 196.10                                                        | 2,399.15                                                   | 11.53                                                                   |

## Sources:

1. U.S. Census Bureau
2. China Customs
3. People's Bank of China
4. U.S. Bureau of Labor Statistics; December Data