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Before the Senate Committee on Banking, Housing, and Urban Affairs

"The Treasury Department's Report to Congress on International Economic and Exchange Rate Policy and the U.S.-China Strategic Economic Dialogue"

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Mr. Chairman, Members of the Committee, I'm delighted to have the opportunity to testify today on exchange rate policy and strategic economic dialogue with China on behalf of the ten million working men and women of the AFL-CIO and the ten unions of the Industrial Union Council.

As you know, these issues go right to the heart of the economic challenges facing America's working families and our middle class, and we in the labor movement feel a certain amount of urgency to develop and implement concrete solutions sooner rather than later. We are working closely with 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 first step in that direction.

In December, the Treasury Department issued its 2006 Report to Congress on International Economic and Exchange Rate Policy (IEERP). The Report finds 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 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 IEERP 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 U.S. trade deficit with China will reach about $230 billion in 2006, up about 15 percent since last year, and the Economic Policy Institute has estimated that the growing bilateral deficit with China has displaced more than one and a half million jobs since 1989.

Now, 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?" [1]

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."

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)	(% GDP)	Accumulation of reserves 12-month change (US$ Billions)	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.

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

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

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."[2]

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 renminbi 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 renminbi 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."[3]

As the Automotive Trade Policy Council pointed out recently, Japan has also intervened aggressively and repeatedly in currency markets to gain an unfair trade advantage, spending nearly $450 billion to keep the yen undervalued since 2000. Not only did the Treasury Department fail to cite Japan as a currency manipulator during this time, but according to John Taylor's recent book, *Global Financial Warriors,* Treasury officials implicitly sanctioned the Japanese interventions. We find this extremely troubling.

I know the Treasury Secretary is no longer here, but I would like to ask Secretary Paulson and his staff exactly what it would 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.

This is not an academic exercise for the union members I 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

[2] 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 .

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

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 with a currency that experts estimate is undervalued by as much as 40 percent. As one manufacturer told the U.S.-China Commission, “it’s like being in a 100-yard race, except the other team gets to start at the 40-yard line.” The Chinese currency regime also sets the pace for others in the region.

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.

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 U.S. 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.[4]

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. 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.

We are baffled and frustrated at our own government's failure to protect the interests of American workers and businesses, and 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

I don't mean to sound cynical, but I'm starting to feel like Bill Murray in the movie *Groundhog Day*. Every year, I or one of my colleagues is invited to testify on these important economic issues. Every year, the trade deficit worsens, more jobs are lost, and the economic pressures on workers and the middle class continue to grow. And every year, someone from the Administration responds with pledges of increased dialogue and cooperation.

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 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.

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

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 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 trade and economic relationship. Certainly, the Administration needs to initiate WTO dispute resolution immediately in several areas to ensure that China meets its obligations in a timely and effective way – including currency manipulation and violation of workers' rights. The Administration should clarify without delay that countervailing duty remedies can be applied to non-market economies.

But Congress cannot wait for this Administration to act.

We urge Congress to give immediate consideration to the Fair Currency Act, which we expect to be introduced shortly (this is a newly updated version of H.R. 1498, introduced in the last Congress by Representatives Ryan and Hunter, also introduced last year in the Senate by Senator Bunning).

I would like to thank Senators Stabenow and Bunning for their leadership in addressing this important issue. 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 does not apply exclusively to China, but is broadly applicable. It is a crucial first step in addressing the urgent economic problems we face today.

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