Currency Manipulation: It's Not Just China

Joseph E. Gagnon says that while China has improved its record on currency manipulation, other countries are keeping the global total high at $1.5 trillion a year, impeding the US recovery.

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Steve Weisman: China is the country often cited when there is talk about manipulation of currency, and indeed China is the target of criticism in the presidential campaign and Congress. This is Steve Weisman with Joseph Gagnon of the Peterson Institute for International Economics, whose new Policy Brief points out that other countries engage in the same practice. Who are the biggest "currency manipulators?"

Joseph Gagnon: There are two parts [to the Policy Brief]. One talks about the scope of the problem, [where] I sum up behavior that could broadly be defined as "currency manipulation." Of course, there are different components to that and one could argue about whether some components fully belong in, but you can construct rough measures. It's a big number, as much as $1.5 trillion every year. This year, last year, next year.

Steve Weisman: What does that measure?

Joseph Gagnon: That measures the total purchases of governments around the world in other country's assets. It's the net increase, it's the net capital flow directed by governments outside their borders.

Steve Weisman: And they do this presumably -- just to do a little bit of Econ 101 -- to keep the value of their own currencies low in relationship to the country whose assets they're purchasing?

Joseph Gagnon: That's correct. That's the overwhelming reason. But there are, within that, a few relatively minor exceptions. Some countries have borrowed in foreign currencies and they're paying those loans back. That gets caught up, but I don't want to call that "manipulation." That's pretty small.

And then the big issue is what about people who have exports of natural resources that are exhaustible. Oil is the biggest one. You deplete your oil, and in the future you won't have any more oil. But you don't want to spend it all today. You want to save it for future generations. And so in the past decade of big phenomenons, countries have set up sovereign wealth funds to invest that oil [revenue] productively for future generations.

That I believe has some elements of currency manipulation. It does certainly depress their currencies and pump up their current account balances. But think that maybe that has some more legitimate purposes too. So I think it should have limits placed on it. But on the other hand, you can see a rationale for it.

Steve Weisman: You had mentioned the oil exporters that are obvious -- Russia and Saudi Arabia. You also mentioned Algeria, but countries like Norway have big oil revenue-based sovereign wealth funds for the reasons that you say. You don't call them a manipulator, evidently?

Joseph Gagnon: They're not on my list. I think that would take more effort and go beyond the scope of what I've done here. But I think it's an issue for the future -- what limit should be placed on that behavior?

Steve Weisman: China has improved its current account imbalance in the last several months. But other countries and economies are not changing their pattern and they're engaging in this manipulation still.

Joseph Gagnon: Yes.

Steve Weisman: What are some of those big ones?

Joseph Gagnon: Just to put it in perspective, this $1.5 trillion a year, as much of a third of it was China at one point. Now it [China] is really falling quite dramatically, but the total isn't falling, which is interesting.

The other big ones, there's a mixed bag. It changes incredibly. Switzerland has risen a lot in the past year and Switzerland has some unique circumstances, which I don't want to get into. But they pop up as manipulating their currency, although they do have a unique circumstance in Europe and a history that they traditionally have done their policy in foreign currencies. I think they're doing it excessively, so I don't want to let them off the hook, but they have some unique features.

Other big ones continue to be the Asians: Malaysia, Philippines, Thailand, Korea, Singapore, still doing it big time. But also, it's spread to a few African countries [and] a number of Latin American countries to some extent.

Steve Weisman: Are they trying to pump out exports there?

Joseph Gagnon: In some cases. One thing that I'm not highlighting in my list is countries like Brazil or Mexico that are actually trying to hold their currencies down moderately, but don't have current account surpluses. They still have small current account deficits. You actually would expect developing countries to have current account deficits. They should borrow for development projects. There's a question of what's the right amount.

Some of them are engaging in this kind of behavior, but not to an extreme degree, so I haven't captured them in my top 20 table, but they're there in the background in terms of why this $1.5 trillion is still hanging on as a big number.

Steve Weisman: How does the $1.5 trillion in purchases of assets translate into loss of GDP in the United States?

Joseph Gagnon: Right now, given that our monetary and fiscal policies have not been adequate to keep the economy on track, [and we] have not been able to fully recover from the recession, and forecasters aren't predicting that we will recover, then in that circumstance this kind of behavior represents a huge loss of demand, a loss of sales that we could have had.

Steve Weisman: Of a magnitude?

Joseph Gagnon: I estimate that this is probably worth about 4 percent of U.S. GDP in terms of lost exports that we could have been having. If these countries who sell us their products, would have used that money to buy our products instead of buying our treasury bonds or lending us the money; if they had instead bought our exports, we would have 4 percent more GDP, which would be anywhere, at least four million jobs and maybe more.

Steve Weisman: Is it really fair to say, "If they had bought our exports instead of buying our assets?"

Joseph Gagnon: That's the question. Buying our assets is a currency manipulation, so if they weren't going to do that, then the other alternative is to buy our exports.

Steve Weisman: Right.

Joseph Gagnon: That's kind of how it works. There is a third option. That's what the data suggests would happen is actually more than four million jobs, because 4 percent of GDP is, 4 percent of the labor force, is more than four million jobs that are missing.

But the one thing I would say is that if we could have had macro policies that would have kept us at full employment and kept us at potential output, then obviously there is no sense in which this is destroying jobs. It would have created more jobs in exports, but we would have had to have tighter policies to choke off demand elsewhere.

So it's only because we are still in recession effectively that this is such a big problem. But given how long we're expected to remain below full employment, I think it's worth highlighting this, because it is important now and will be.

Steve Weisman: And also worth undertaking some policies to correct it?

Joseph Gagnon: I think even if we were back at full employment, these imbalances, these massive surpluses that some countries have built up, show up in deficits elsewhere. It's mostly been the U.S. And that's just is not good in the long run for us or even for them. It's a distortion to the world economy that is not good.

Steve Weisman: Remind us what policies you would advocate.

Joseph Gagnon: I think the best policies would be to have international rules that international organizations could enforce multilaterally.

Steve Weisman: And in the absence of that?

Joseph Gagnon: In the absence of that, or in an attempt to negotiate towards that solution, I think the United States could tax currency manipulation. What we could do basically is tax either the actual purchases of the U.S. assets by manipulators or tax the incomes that they earn on those assets that they hold in the U.S. That would hit them right in the pocketbook, which is of course where we would possibly change their mind.

Steve Weisman: Thank you.

Joseph Gagnon: OK.