¥ € £ $ ₩

U.S. Trade Agreements & Currency Manipulation

AAPC

AMERICAN AUTOMOTIVE POLICY COUNCIL

FCA FIAT CHRYSLER AUTOMOBILES Ford GM

Topline

- Currency exchange rates, as the medium in which trade occurs, can be as important a determinant of trade outcomes as the qualities of the goods or services themselves.
- Some governments work with their central banks and other partners to manipulate their currency's value in order to provide their exporters an unfair competitive advantage.
- While the International Monetary Fund (IMF) and the World Trade Organization (WTO) have rules against these practices, no steps have been taken to stop them.
- Korea and Japan have engaged in currency manipulation that favors their automakers, with harmful effect on U.S. and EU manufacturing and job markets.
- Unless free trade agreements (FTAs) prohibit this kind of currency manipulation, it will fail to achieve its objectives. In fact, a poorly negotiated FTA that allows countries to continue to undermine trade agreements by manipulating their currencies – will harm U.S. and EU economies, exports and the jobs they support.

How Manipulation Affects the U.S.

Currency manipulators effectively protect jobs in their home country at the expense of jobs and economic growth in their trading partners' economies.

A December, 2012 Peterson Institute for International Economics (PIIE) study, "**Currency Manipulation, the U.S. Economy, and the Global Economic Order**," explains that:

1. A "buildup of official assets – mainly through intervention in the foreign exchange markets – keeps the currencies of the interveners substantially undervalued, thus boosting their international competitiveness and trade surpluses…"
2. "The most important no interveners by far are the United States and the euro area… overall, we believe **a conservative range of the [impact on current account balances] for the United States is $200 billion to $500 billion and for the euro area is $150 billion to $200 billion."**
3. "**The United States has thus suffered 1 million to 5 million job losses. Half or more of excess US employment**."
4. "(t)he United States must eliminate or at least sharply reduce its large trade deficit to accelerate growth and restore full employment. **The way to do so, at no cost to the US budget, is to insist that other countries stop manipulating their currencies** and permit the dollar to regain a competitive level."
5. "**Eliminating excessive currency intervention would narrow the U.S. trade deficit by 1 to 3 percent of GDP and would thus move the U.S. economy much of the way to full employment**, with an even larger effect possible…"

"…Millions of Americans and Europeans would be employed if other countries did not manipulate their currencies and instead achieved sustainable growth through higher domestic demand."

Peterson Institute *Combating Widespread Currency Manipulation* July 2012

"The logical place to start [including currency manipulation disciplines in FTAs] is the proposed US-EU trade agreement, in which both parties should find common cause in renouncing currency manipulation ."

Peterson Institute *Currency Manipulation, The US Economy and the Global Economic Order* December 2012

AAPC
AMERICAN AUTOMOTIVE POLICY COUNCIL

Multilateral Disciplines

International Monetary Fund & World Trade Organization:

The charter of the International Monetary Fund prohibits members from manipulating their currency. The IMF charter states that ***"members should avoid manipulating exchange rates in order to gain an unfair competitive advantage over other members" and defines such manipulation as "protracted, large-scale intervention in one direction in the exchange market."***

The World Trade Organization also prohibits currency manipulation- GATT Article XV states that ***"contracting parties shall not, by exchange action, frustrate the intent of the Agreement nor by trade action, the intent of the provisions of the Articles of Agreement of the IMF."*** but points back to the IMF.

However, neither organization has taken action against currency manipulators.

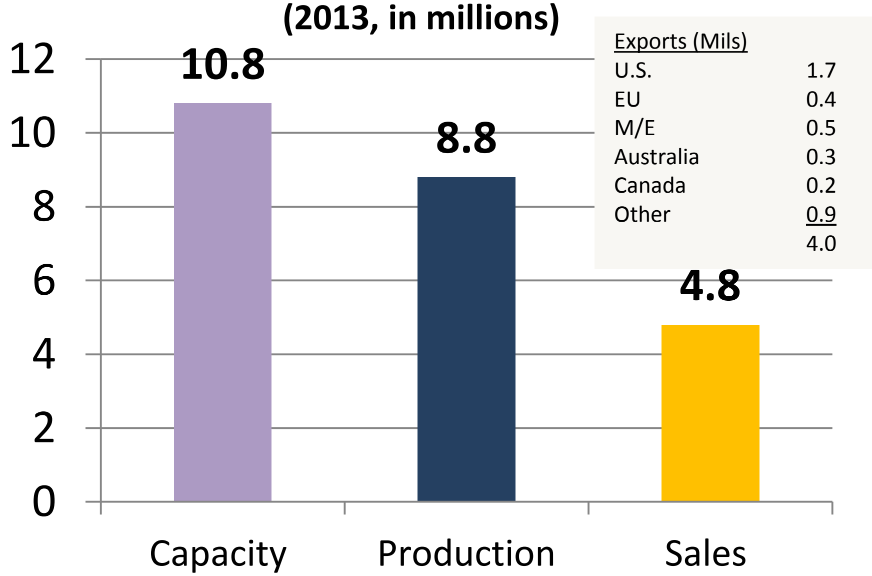
Industrial Overcapacity

Why would a nation manipulate its own currency in a way that makes it harder for its citizens to afford imported products? Because its economy depends substantially on the exports of one or two of its biggest industries

In Korea and Japan, governments have taken dramatic steps to maintain production capacity in auto plants by subsidizing the exports of vehicles to other markets. Therefore avoiding the need to right-size their industry, and instead push off that burden on to their trade partners

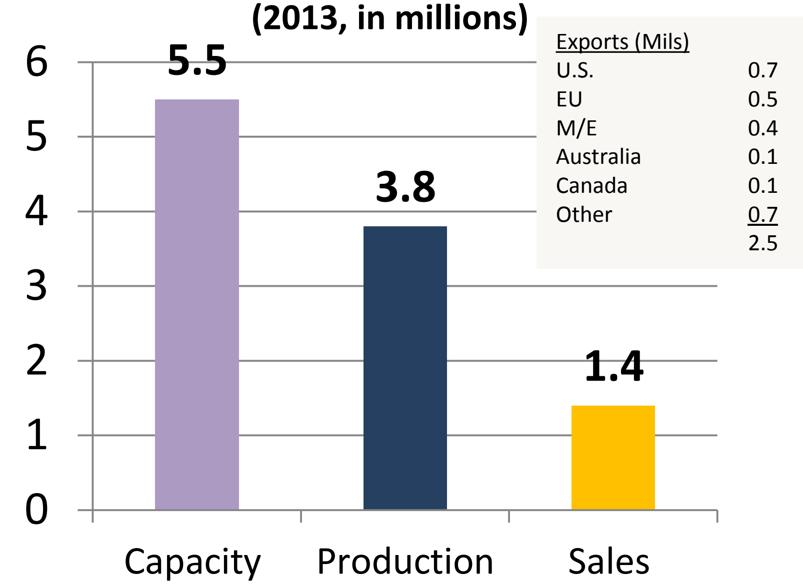
JAPAN AUTO PRODUCTION

(2013, in millions)



KOREAN AUTO PRODUCTION

(2013, in millions)

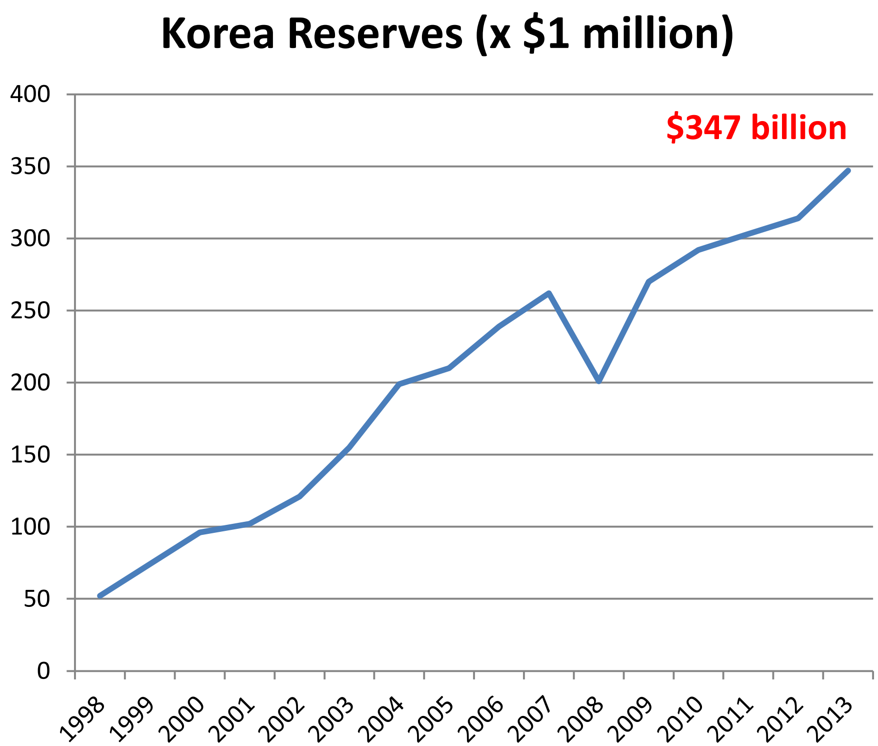


Source: Global Insight

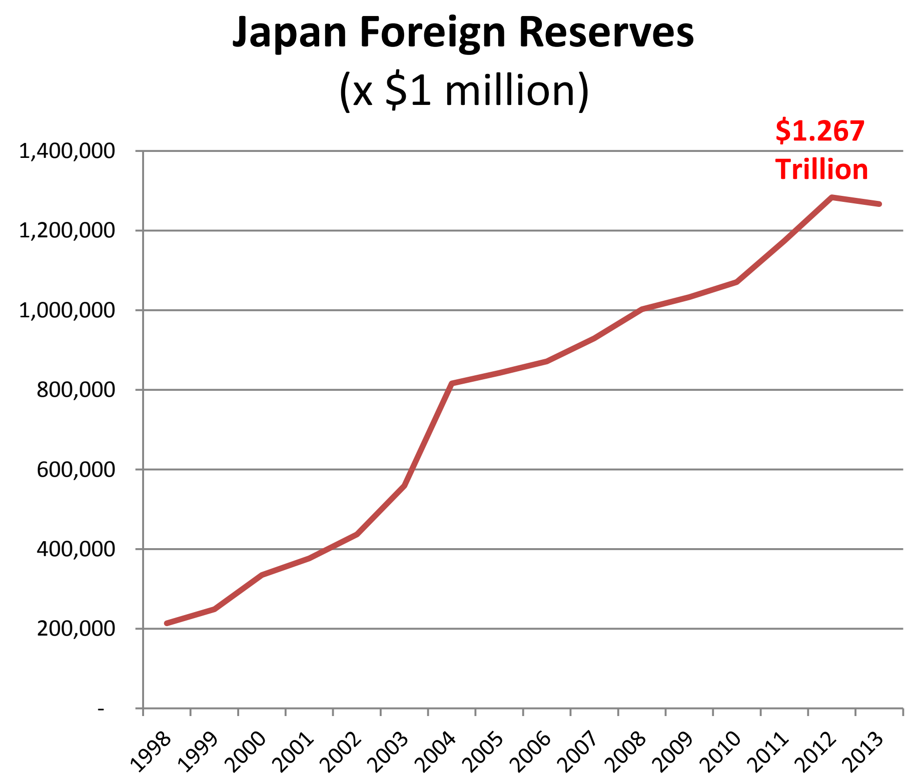
AMERICAN AUTOMOTIVE POLICY COUNCIL

Foreign Currency Reserves

A clear sign a country is manipulating (weakening) its currency is a substantial increase in its foreign currency reserves, which occurs as it buys and holds foreign currencies (in large part $ & €).



Source: Bank of Korea; for 2013, IMF



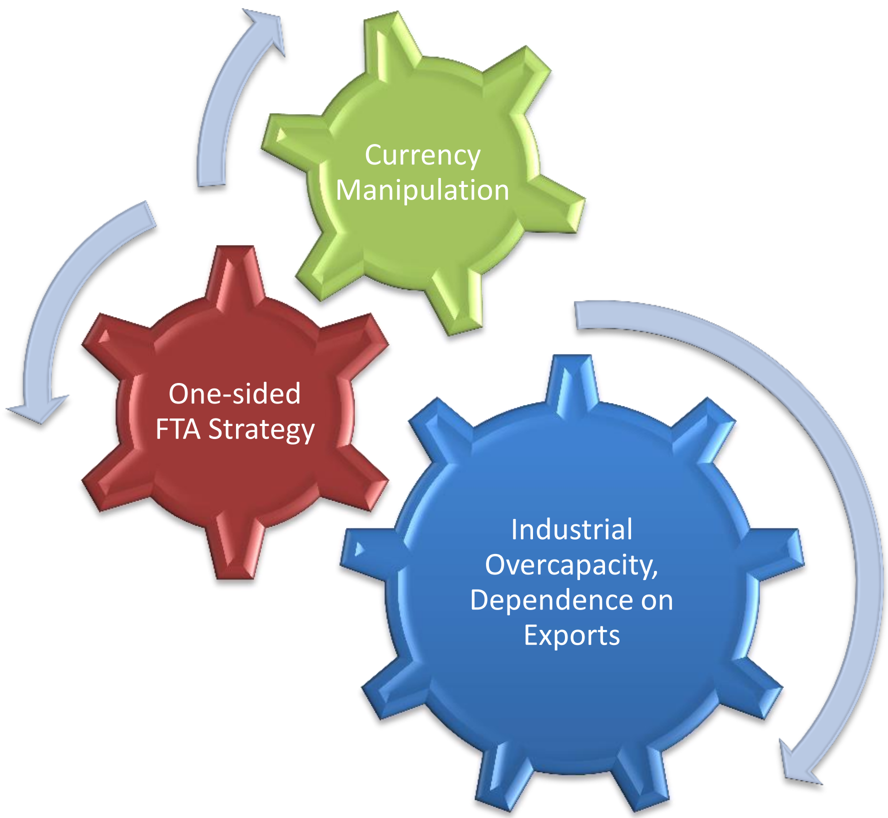
Source: Bank of Japan; for 2013, IMF

AAPC
AMERICAN AUTOMOTIVE POLICY COUNCIL

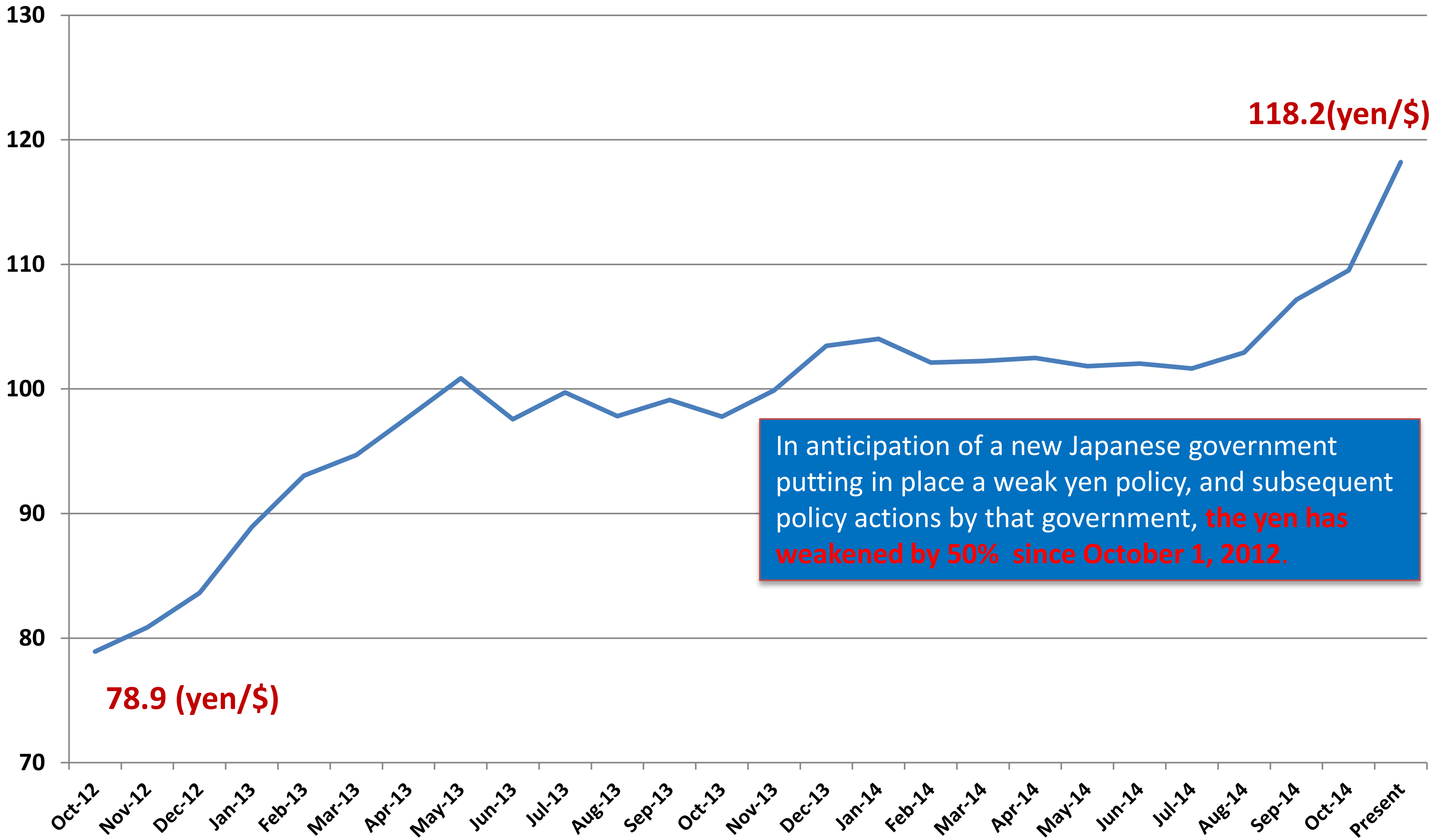
Japan’s Trade Tactics

Because cars, trucks and auto parts are its largest export, Japan has used direct intervention in currency markets – and the threat of intervention – to gain a competitive export advantage.

At the same time, Japan seeks admission into free trade agreements (FTAs) with the US, EU, Canada, etc.., which would grant it preferential treatment in trade with those key trade partners and markets.

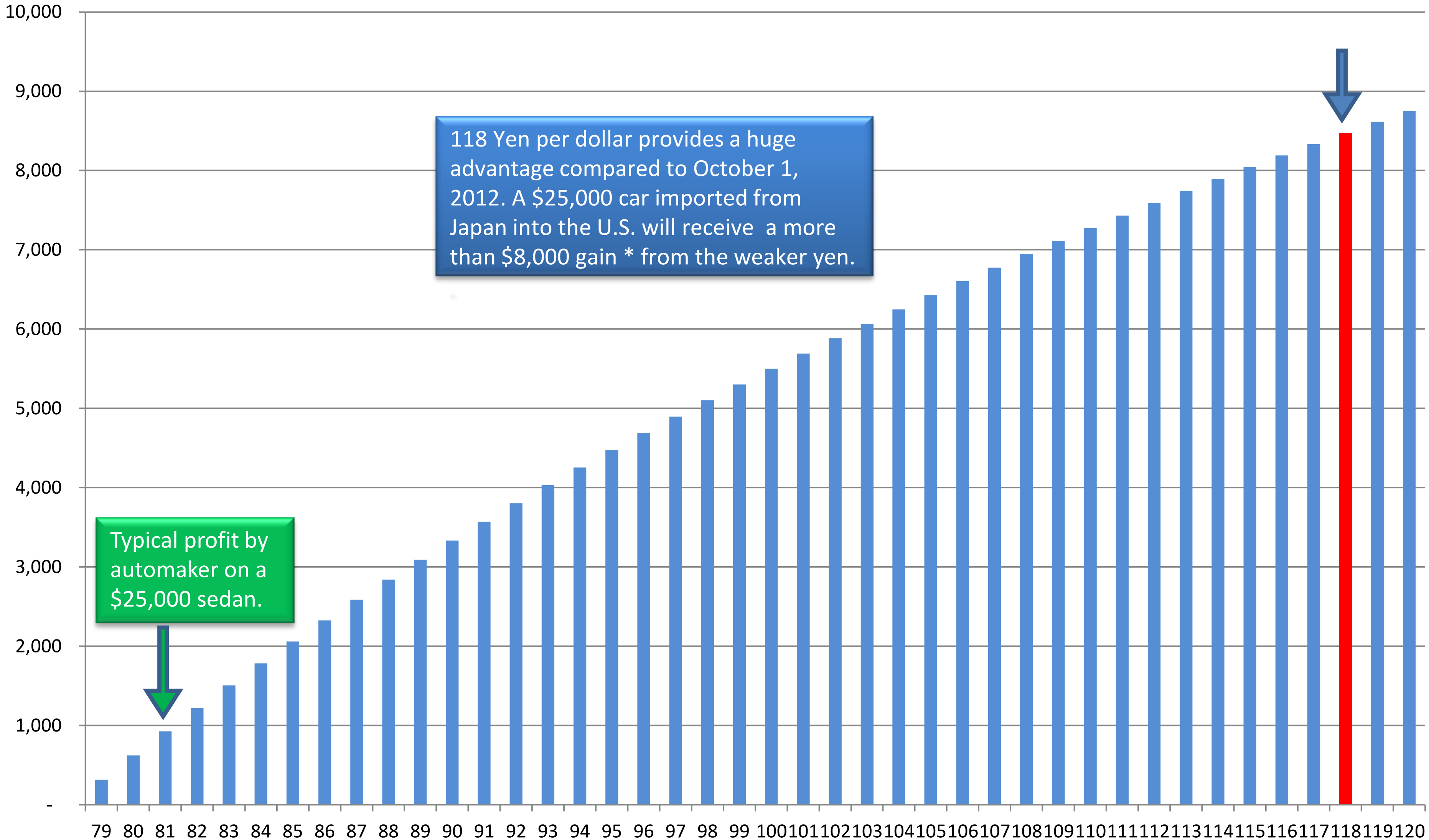


Recent Weak Yen Policy Impact



AAPC
AMERICAN AUTOMOTIVE POLICY COUNCIL

Weak Yen Subsidy Per Car in U.S.



- Based on the October 1, 2012 rate of 78 yen/$, when Abenomics started.
- 3-4% profit margin on sedan. Source: McKinsey & Company, *2003 Preface to the Auto Sector Cases*

Yen Value Benefit for Japan's OEMs

- TOYOTA: *"A one-yen decline against the dollar adds about 40 billion yen **($404 million) to Toyota's operating profit**…"* – Bloomberg, Feb. 5, 2014

- HONDA: *"According to Honda, its operating income gains by 16 billion yen **($172 million) annually for every one-yen drop in the dollar rate…"*** – Bloomberg, Feb. 1, 2013

- NISSAN: *"Nissan CEO Carlos Ghosn has said that every one yen gain against the dollar **cuts 20 billion yen ($228 million) from operating profit** and that 100 yen to the dollar is optimal."* – Nissan Report, Jan. 11, 2013

118 yen per dollar represents an annual unearned subsidy of $5.7 to 16.2 billion for Toyota , $2.4 to 6.9 billion for Honda, and $3.2 to 9.1 billion for Nissan.

•Range is based on the October 1, 2012 rate of 78 yen/$, when Abenomics started, to the 104 Y/$ that Japanese OEMs projected.

AAPC
AMERICAN AUTOMOTIVE POLICY COUNCIL
FCA Ford GM

What Others Are Saying About Currency & FTAs

Coalition of 10 US Business Assoc. - May 22nd 2012 letter to Treasury Sec Geithner & USTR Kirk:

"…we strongly recommend that the United States government pursue, as a leading priority, inclusion of strong currency disciplines in all future free trade agreements, including the Trans-Pacific Partnership (TPP) agreement."

Peterson Institute, "Currency Manipulation, the US Economy, and the Global Economic Order":

"Efforts should be made to include the [currency] manipulation issue in future trade agreements at all levels (multilateral, regional, and bilateral)."

Woodrow Wilson Center, "Negotiations for a Trans-Pacific Partnership":

"If the TPP negotiations are to fulfill this promise, however, it is critical that the rules be right. This means that they must deal with the major gaps in the World Trade Organization rules, such as…addressing currency manipulation, an issue that is not currently on the TPP negotiating table."

Economic Strategy Institute, "The Trans-Pacific Partnership and Japan":

"Although the TPP is being touted as a "Twenty First Century" agreement, it is, in fact, nothing of the sort in terms of substance….In order to become a truly 21st century trade agreement, the TPP must be expanded to include provisions barring currency manipulation…"

Canadian Imperial Bank of Commerce, "Free Trade, Free Currencies":

"So let the negotiations continue, not just on trade, but on currencies, other distortionary policies, and their implications for global imbalances. Free trade, but free currencies as well."

What Congress Has Said About Currency & FTAs

A majority of the Senate (60), in a September, 23 2013 letter to the President:

"As the United States negotiates TPP and all future free trade agreements, we ask that you include strong and enforceable foreign currency manipulation disciplines to ensure these agreements meet the "high standards" our country, America's companies, and America's workers deserve.

A majority of the House of Representatives(230), in a May 13, 2013 letter to the President:

"Despite U.S. efforts to address currency manipulation at the G-20, major currencies remain significantly undervalued. Including currency disciplines in the TPP is consistent with and will bolster our ongoing efforts to respond to these trade-distorting policies. It will also raise TPP to the 21st century agreement standard set by the Administration."

Senators Baucus and Hatch and Congressmen Camp and Levin in a November 8, 2011 letter to the President:

"New disciplines on non-tariff barriers, as well as other rules, such as restrictions on the operations on the operation of state-owned enterprises, being proposed for TPP, could, if sufficiently robust, be applied to address some of these concerns..."

Senator Hatch, Ranking Member of Finance Committee, in a January 18, 2012 letter:

"Addressing currency manipulation in the TPP becomes particularly important as the Administration considers the possibility of new TPP participants, such as Japan, who have demonstrated a pattern of currency interventions."

Proposal: FTAs & Currency Manipulation

- Working with economists with currency expertise, AAPC developed a three-part test that determines whether a country is manipulating its currency. The test draws on indicators produced by the IMF and purposefully does not impede on a countries' flexibility to utilize sovereign monetary policies, such as quantitative easing.

  - ***Did the country have a current account surplus over the six-month period in question?***
  - ***Did it add to its foreign exchange reserves over that same six-month period?***
  - ***Are its foreign exchange reserves more than sufficient (i.e., greater than three months' normal imports)?***

- Additionally, AAPC proposed that FTA partners would be obligated to share information including their foreign exchange holdings and their interventions to acquire foreign assets on a quarterly basis in compliance with their IMF transparency obligations.

- We also propose that, like other binding commitments in an FTA agreement, the prohibition on the manipulation of exchange rates by a member of the FTA and the transparency obligations discussed above would be enforceable through the agreement's dispute settlement process.

Conclusion: FTAs & Currency Manipulation

- FTAs are negotiated between countries that agree to provide preferential access to each others' markets, and are carefully negotiated to be mutually beneficial.
- Currency manipulation by one country can completely undermine the expected benefits of a FTA, and have an adverse impact on the economy and jobs of the their trade partners.
- While the International Monetary Fund (IMF) and the World Trade Organization (WTO) have rules against these practices, no steps have been taken to stop them.
- Given this, many have come to the conclusion that prohibitions on currency manipulation need to be included in future FTAs. And, if a FTA partner manipulates its currency, thereby undermining its expected benefits of the FTA, it would lose the benefits of the agreement
- Many in the U.S. business community and in the US Congress are now calling for the TPP agreement, and all future FTAs that include the United States, to include disciplines on currency manipulation.
- **AAPC has developed a reasonable three-part test that determines if a country is a currency manipulator. We believe that in order to meet the needs of the 21st century agreement, this kind of strong and enforceable disciplines needs to be included in all future U.S. FTAs.**

AAPC
AMERICAN AUTOMOTIVE POLICY COUNCIL