An Explanation of the Competitive Dollar for Jobs and Prosperity Act
(Long Version)

April 20, 2018

Summary

The Competitive Dollar for Jobs and Prosperity Act would task the Federal Reserve with achieving and maintaining current account balance and give it the tools to achieve that goal. These tools are designed to neutralize the excessive private capital inflows and currency manipulation by foreign governments that drive up the US dollar, making American goods and services less competitive in foreign and US markets and increasing the trade deficit.

Discussion

America's persistent ongoing trade deficit is finally being recognized as a significant economic and political problem.

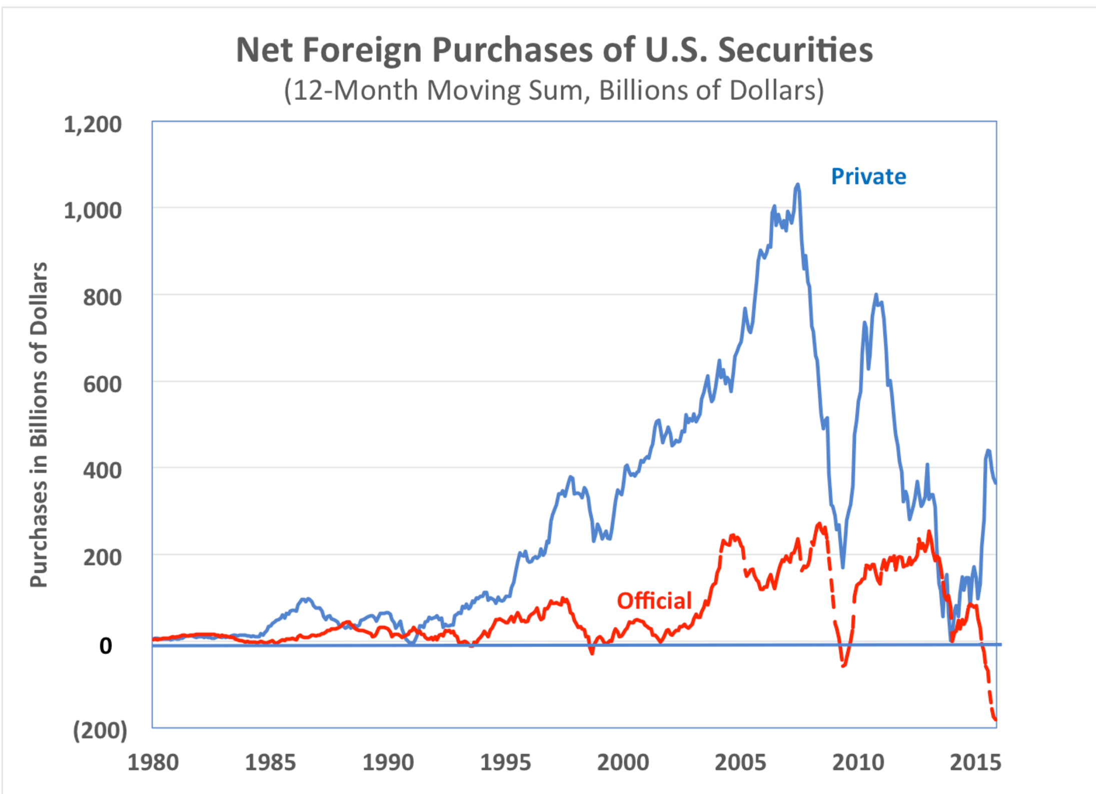
Trade enforcement and tariff action are now being used to address issues of national security (section 232, 1962 Trade Expansion Act), intellectual property theft (section 301, 1974 Trade Act), and serious industry harm (section 201, 1974 Trade Act). Such tariffs can effectively remedy sector-specific trade impediments, manage the composition of US trade, and, if applied to a sufficiently large percentage of imports from a particular country, remedy bilateral trade imbalances.

However, tariffs alone cannot lower the value of the dollar enough to balance trade overall. Why? Because when tariffs reduce imports, they create upward pressure on the USD exchange rate. This results in reduced US exports and more imports in sectors and from countries not subject to tariffs, thus offsetting most of the effect of the tariffs on the overall balance of trade.

To reduce and eliminate its trade deficit America needs other, more direct ways to manage the dollar's exchange rate. Without it, our economy is subject to the actions of both foreign governments and private sector actors who want to accumulate more dollar assets.

Foreign central banks and sovereign funds often accumulate dollar reserves to protect themselves from capital market pressures or to gain a trade advantage by holding down the value of their currencies. During the "decade of manipulation"--2003 to 2013--20 countries, including China, manipulated their currencies in this way.[1] The US current account deficit reached its highest levels on record during that period. Although China is not now manipulating its currency, other countries continue to do so. And there is every reason to believe that China will resume the practice when it serves its interests.

The other key driver of USD overvaluation is large net private capital inflows—purchases by foreign persons of USD securities in US markets that greatly exceed sales. Foreign private capital is attracted to the US because (a) the dollar is the world's reserve currency and a safe store of value; and (b) because America's securities markets are also the largest, most liquid, and most secure in terms of the rule of law. Even during the peak years of currency manipulation (2000 to 2010), this net private inflow was 3.8 times larger than the amounts of USD securities accumulated by foreign central banks. And from 2010 to 2015, average net private inflows were $150 billion per year, while foreign central bank banks were actually selling over $100 billion of US securities annually.[2]



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[1] Bergsten and Gagnon, "Currency Conflict and Trade Policy," pp. 69, 72, Peterson Institute for International Economics, 2017.

[2] Calculations by John R. Hansen based on data from the Treasury International Capital System.

Whether the excessive net purchases of US assets are private or governmental, the result is the same: a dollar price that exceeds the current account-balancing equilibrium price and makes all US goods and services less competitive in both domestic and overseas markets.

Facing a large current account deficit in 1985, the Reagan administration abandoned its "benign neglect" of the dollar and negotiated the Plaza Accord. The dollar was devalued by 30 percent over the next 18 months[3], bringing the US current account into balance by 1991. No US administration has addressed dollar exchange rates since that time.

As of May 2017, the dollar was 25 percent overvalued (against a trade weighted basket of currencies) compared to the set of exchange rates that would bring US trade into balance.[4] The dollar has fallen somewhat in the last year, but remains far above its trade-balancing equilibrium price.

The US Treasury Department has recognized this problem:[5]

> In general, current account surpluses among several major trading partners over the last two decades have proven both large and persistent. The global adjustment process has not worked effectively in the post-crisis era to promote a symmetric adjustment toward smaller imbalances in a manner that sustains – rather than inhibits – global growth. Nor are there signs that typical adjustment mechanisms – most notably real exchange rates and relative rates of demand growth – are currently pointing toward a narrowing of external imbalances.

The United States does not have effective tools to manage this aspect of trade policy.

The Competitive Dollar for Jobs and Prosperity Act

The Competitive Dollar for Jobs and Prosperity Act (see draft bill attached) would establish an exchange rate management policy and provide tools to administer it.

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[3] Bergsten, supra at 14.

[4] For a detailed explanation of the 25% undervaluation estimate and the MAC, see the Coalition for A Prosperous America (CPA) paper The Threat of US Dollar Overvaluation: How to Calculate Exchange Rate.com Misalignment and How to Fix It.

[5] Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States, April 13, 2018, p. 30

The Act would charge the Board of Governors of the Federal Reserve with achieving and maintaining current account balance for the United States. It would authorize and direct the Fed to charge a variable rate fee—the Market Access Charge—on incoming capital to deter and reduce excessive inflows. It would also authorize the Fed to neutralize exchange rate manipulation by other governments through countervailing intervention in foreign exchange markets.

Specifically, the bill would:

1. Amend the Federal Reserve Act to add a third mandate—achieving and maintaining current account balance—to its two existing mandates of full employment and price stability.

2. Create an exchange rate management tool to be administered by the Fed—the Market Access Charge (MAC)—to gradually achieve a trade-balancing price for the US dollar.

    2.1. Instruct the Fed to set and adjust the MAC, moving it higher or lower as needed, to moderate incoming capital flows to achieve current account balance

    2.2. Allow the Fed to consider impacts on US economic output, employment, interest rates, and markets in setting and adjusting the MAC.

3. Define "covered transactions" as all foreign purchases of securities and other US assets denominated in USD.

4. Task the Treasury with administering the collection of the MAC. The MAC would be charged to purchasers and remitted to the Treasury by banks and non-financial institutions that already electronically report on these transactions under the Bank Secrecy Act and from transfer agents that already report under the Securities Exchange Act.

5. Authorize the Fed to engage in countervailing currency intervention to neutralize currency manipulation by other countries.

Questions and Answers:

Question: Is the bill compatible with international law and regulation?

Answer: The IMF has approved capital flow management tools like the MAC since 2012. The MAC would also be WTO-compliant since WTO rules do not deal with capital flows.

Question: Will reducing foreign demand for US Treasuries and other US assets raise US interest rates, stifling economic recovery?

Answer: Unlikely. The weaker dollar will increase foreign and domestic demand for US products and reduce foreign competitors' market share in US and foreign markets. Over time—the consensus is about two years—the increase in production and investment caused by the weaker, more competitive dollar will stimulate the economy. If interest rates begin to rise before then, the Fed has powerful monetary tools, including control of the federal funds rate, open market operations, and quantitative easing, to maintain short- and long-term interest rates at target levels. Any upward pressure on rates from the MAC would be fully offset.

Question: Who developed the MAC?

Answer: The MAC was first proposed by John R. Hansen, an international economist and 30-year veteran of the World Bank. The concept and the draft bill have been developed and extensively vetted by the Coalition for a Prosperous American (CPA) as well as Joe Gagnon (Senior Fellow, Petersen Institute international Economics) and Rob Scott (Senior Economist and Director of Trade and Manufacturing Policy Research at the Economic Policy Institute).

Question: What would be the jobs and growth impact of the Act?

Answer: Since America's trade deficit is largely in manufactured goods, the jobs and economic growth that ending the deficit would bring back would initially be concentrated in manufacturing. Expansion in related services sectors and upward pressure on wages in other industries would follow.

Question: How much revenue would the Act generate?

Answer: The MAC would generate substantial revenues, well into the billions of dollars in its early years. The amount would increase as the MAC charge ramps up to start the dollar on a downward path and stabilize within a somewhat lower range when current account balance is achieved.

Question: How does the countervailing currency intervention part of the Act fit with the MAC?

Answer: When a country manipulates or devalues its currency to drive up the dollar, that action is best addressed by countering that country's actions directly rather than increasing the MAC charge for all inflows. Using only the MAC for single country manipulation would force the MAC higher than otherwise required, penalizing “innocent bystander” countries.

Question: Would we need tariffs when the MAC is in place?

Answer: Yes. Tariffs address different problems such as trade law violations and sub-optimal composition of trade and production. For example, the US is now running a $103 billion deficit in advanced manufactured goods because of trade barriers and intellectual property theft by other countries as well as the overvalued USD. To avoid balancing trade by selling more soybeans and natural gas, while leaving much of this high tech deficit in place, tariffs are still needed alongside the MAC.

Question: Would the Act’s new current account balance mandate, coupled with the tools to pursue the mandate, complement the Fed’s existing mandates of full employment and price stability?

Answer: Yes. The Act would give the Fed the mandate to balance the current account and the tools to accomplish this by directly controlling USD exchange rates. This would allow the Fed to carry out domestic monetary and fiscal policy without offsets or interference from foreign government currency manipulation or private sector capital markets. In fact, the Act would complete the suite of tools required to effectively manage the US economy.

Question: What industries support the MAC concept?

Answer: As of April 16, 2018, trade associations representing tooling, machining, agriculture, and copper have officially supported the bill. CPA will maintain a real time list on its website.

Question: What congressional offices support the MAC concept?

Answer: 140 congressional offices, from both parties, have responded favorably in the past year. Some of these offices support tariffs and some oppose tariffs, indicating that exchange rate management could generate broader support than other trade measures.