Global Conflict over Exchange Rates, Part One

Joseph E. Gagnon and John Williamson discuss the phenomenon of currency manipulation by China and other countries and why the United States and Europe are adversely affected. This is the first of a three-part discussion.


Steve Weisman: I am here with two experts at the Peterson Institute for International Economics to discuss why exchange rates are so important right now in the slumping world and American economy. This is Steve Weisman with Joseph Gagnon and John Williamson at the Institute. Let me start, Joe, with you. You’ve produced new findings about exchange rate manipulation showing who are the bad actors in the world. Tell me a little bit about it.

Joseph Gagnon: The Policy Brief I wrote is motivated by a change in the world’s behavior, dramatically, in the past ten years, in which governments which have often made some efforts to manage their exchange rates launched into massive one-way purchases of foreign assets to a scale that had never happened before. This has [been] led by China and of course. We all know in America there’s been a lot of focus on that behavior by China, trying to hold its currency down against the dollar just to maintain its export-led growth. But what I notice is, it’s not just China. Even at the peak, it was less than half China, and China has changed a lot, so other countries may be stepping in to fill in the gap and I wanted to shed some light on who is it, besides China.

Steve Weisman: And the extent of this problem right now is what?

Joseph Gagnon: For last year, 2011, my best estimate is somewhere around $1.25 to $1.5 trillion was spent by governments around the world trying to hold their currencies down and trying to keep their exports up.

Steve Weisman: And their reserves of foreign assets up, I guess?

Joseph Gagnon: Right, yes. Foreign exchange reserves grew by about $1 trillion last year, but there are some things that are missing from that calculation -- most notably, sovereign wealth funds, mainly of oil exporters, which probably grew a few hundred billion. This is just an enormous number. This is equivalent to 10
percent of the entire U.S. economy. That’s a big number. Never happened before in history, and it’s been going on for several years now, so it’s not just a one year thing.

Steve Weisman: Translated in terms of lost opportunities for the United States, you calculate the impact on U.S. employment would be what?

Joseph Gagnon: It’s particularly important now because U.S. monetary policy is very loose and interest rates are at zero, they can’t go any lower. There’s some debate about what the Fed could do. Fiscal policy, it doesn’t seem like Congress, for various reasons, is going to act; maybe they should. But for whatever reason, the U.S. has no ability to offset the effect of this and so it’s having a big effect on our economy. I estimate several million jobs, as many as four million jobs, may be lost due to this behavior. It’s hard to be precise. Before this, back five years ago, there wasn’t such a big employment effect because we were able to offset it through other means. We were able to have lower interest rates and keep the economy growing. Basically, we lost our tradable exports and we instead built houses, but that’s hard to do now.

Steve Weisman: John Williamson, countries have a lot of reasons for manipulating their exchange rates, don’t they?

John Williamson: I don’t disagree with Joe about the impact that this is having; it’s not just the United States, it’s all the West is in a recession and remains in a recession five years after the recession first started and that’s serious. But I do think that one needs to ask whether countries are being that unreasonable in seeking to accumulate reserves.

Steve Weisman: Why?

John Williamson: Because there was a lot of evidence—well, it’s often asserted at any rate – that the countries that came through the last recession much better built up their reserves, had high reserves. And basically, after the Asian crisis, there was a feeling among many of the Asian countries that they had been unfairly targeted by the West and that they weren’t going to let it happen again.

Steve Weisman: Excuse me for interrupting, but let’s remind our readers and listeners when the Asian crisis was.

John Williamson: The Asian crisis was basically in 1997-98. Then when they came out of that crisis, some of the countries felt that they’d been unfairly persecuted by the West and that they wanted to make sure that by having high reserves, since
the West wasn’t going to insure them, they were going to self-insure by building up their reserves. And that’s what they’ve done. I agree that it creates problems for the West, but I think that one has to recognize that these are problems which, first of all, the West created, and secondly, that it’s necessary to recognize that there is some logic in the process that they’re trying to do. There’s some justification for what they’re trying to do.

Steve Weisman: I’m going to stop there and end the first part of this interview and pick up with a comment you just made in part number two, which will run the next day. Thank you both.