Mitchell's Musings 1-5-15: Not Just a Chinese Problem

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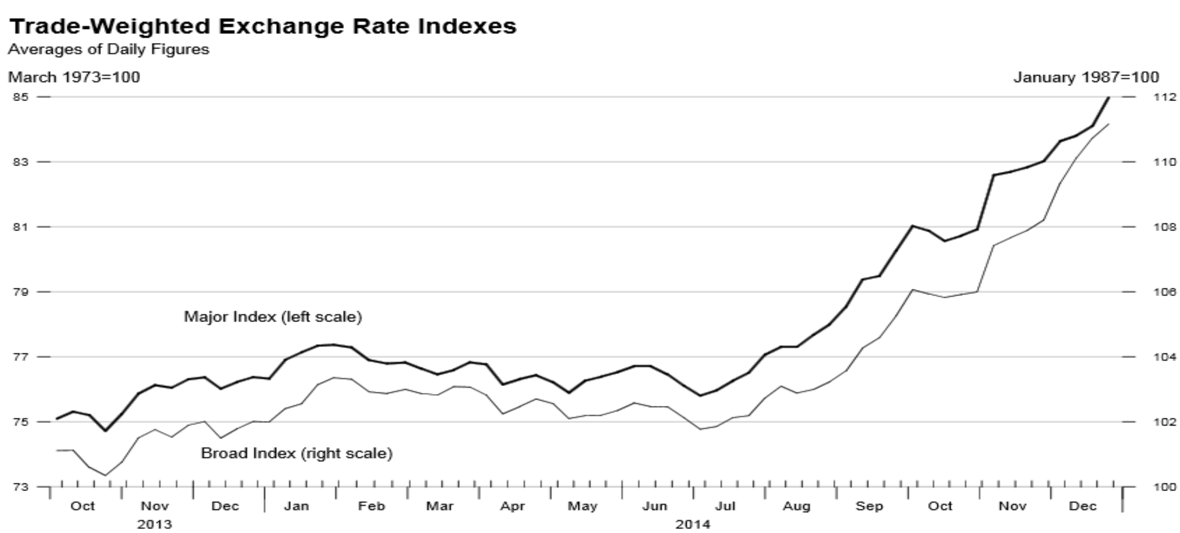
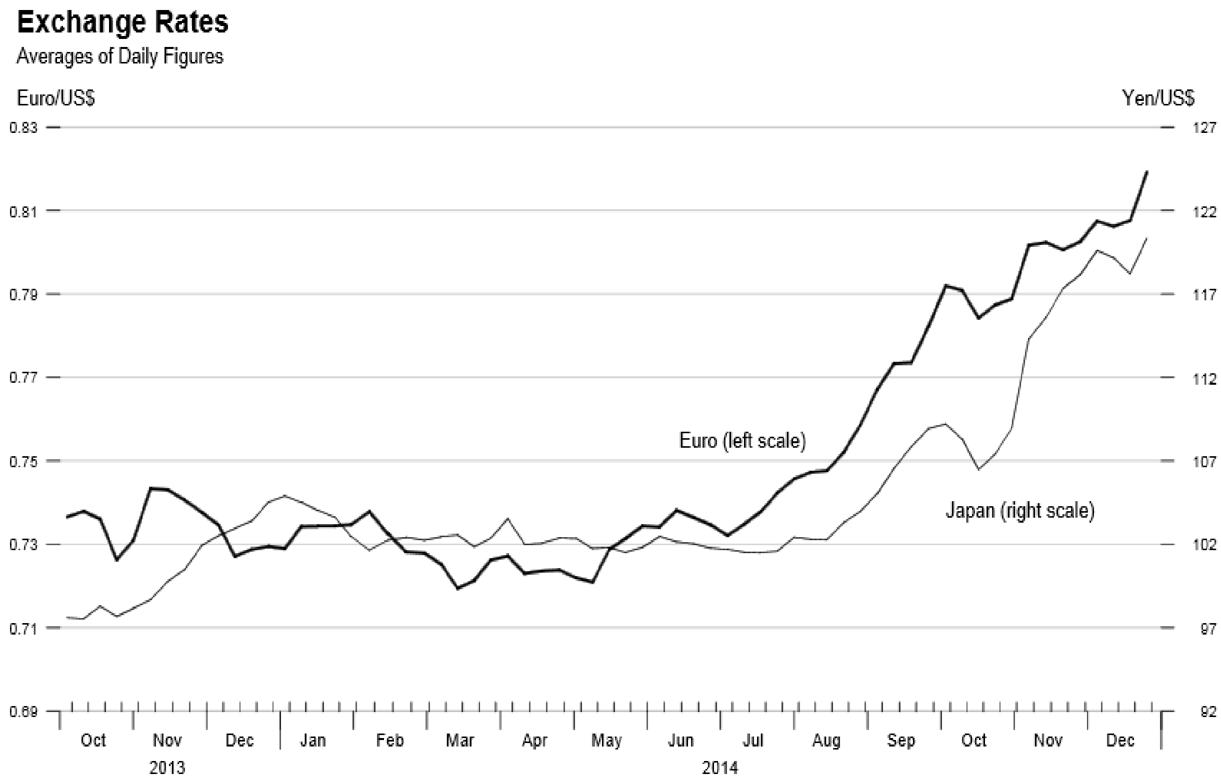
When complaints are heard about currency exchange rate manipulation, the focus is usually on China. But if you went back in time, say back to the 1980s, you would have heard the same complaints about Japan. The fact is that for various reasons, the world has long tended to view the U.S. as a remedy for local concerns about employment and growth. Need more jobs; just export more to the U.S. and import less from the U.S.

The impact on the U.S. from being the stimulus of last resort varies with the condition of the American economy. When the U.S. has a soft economy, the result is fewer jobs here; the counterpart of more jobs there. When the U.S. is closer to full employment, the impact here is more on the *type* of jobs than on the *number* of jobs.

Right now, the European economy isn't doing particularly well, nor is Japan's. So what do we see? As the charts below and on the next page show, the dollar is rising in value relative to a weighted average of world currencies.[1] And the currencies particularly responsible now are the euro and the yen. It's not China this time around.



[1]http://research.stlouisfed.org/publications/usfd/20141231/usfd.pdf



A key sector in the U.S. that is affected by exchange rates is manufacturing. Even if the U.S. economy is doing well, an exchange rate appreciation of the dollar tends to weaken that sector. In some cases, the damage is permanent. You can't turn a steel mill on an off. Once off, it tends to stay off. Deindustrialization is much easier than industrialization.

One of the oddities of American politics is the dissolution of the old Roosevelt/New Deal voting coalition. Democrats nowadays keep wondering why they have lost support among white blue-collar workers. Don't they understand their self-economic interests? You have only to look at the shrinkage of manufacturing jobs to find the answer. Neither party wants to address the manufacturing jobs issue beyond vague statements about favoring education and training. Democrats make invocations of new techy products, e.g., solar panels, but new products, just as old ones, are importantly affected by the exchange rate. Republicans – who don't like "picking winners" – tend to use non-economic "social" issues to hold on to the white, blue-collar vote. Since neither party is effectively addressing the economic issue, those self-interests the Democrats puzzle over, the social concerns are what's left over.

There is the old adage that the definition of madness is doing the same thing over and over again and expecting a different result. But the adage works in reverse. *Avoiding* doing something over and over again and expecting a different result is also crazy. In this case, the U.S. avoids the exchange rate issue and has for decades, regardless of which party is in control. The only consistent economic result has been a chronic imbalance of U.S. imports relative to exports (particularly a burden on manufacturing) and the emergence of a resulting massive debt by the U.S. to the rest of the world. The only consistent political result has been the continued dissolution of the old New Deal coalition.

As we have noted in previous Mitchell's Musings, there are things that could be done about the exchange rate and the tendency of various countries, not just China, to see the U.S. as the jobs stimulus package of last resort. We have noted in particular that there are things that could be done that don't single out particular countries as villains. We have noted the suggestion of financier Warren Buffett – made back in 1987! – that the U.S. could reward exporters with $1 import entitlement vouchers for each $1 of exports and require importers to have them. Such a cap-and-trade program would ensure a zero trade balance, stop the growth of U.S. debt to the world, and end practices abroad of exchange manipulation.[2]

Undoubtedly, you can see complications in the Buffett solution, administrative and diplomatic. Perhaps you would like to argue about secondary effects of the Buffett plan or about relative saving rates in the U.S. and abroad. But have you got a better plan? An alternative proposal? Or do you propose not doing the same thing over and over again and expecting a different result?

[2]https://docs.google.com/document/d/1SFiISDsdphrQS0Q_x0mREd7kHuIiVbKNSrni1MRBCwE/edit