S. HRG. 107-881

U.S. DEPARTMENT OF THE TREASURY'S REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON

THE U.S. DEPARTMENT OF THE TREASURY'S REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY

MAY 1, 2002

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

85-735 PDF

WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

S241-11

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

PAUL S. SARBANES, Maryland, *Chairman*

CHRISTOPHER J. DODD, Connecticut
TIM JOHNSON, South Dakota
JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
EVAN BAYH, Indiana
ZELL MILLER, Georgia
THOMAS R. CARPER, Delaware
DEBBIE STABENOW, Michigan
JON S. CORZINE, New Jersey
DANIEL K. AKAKA, Hawaii
PHIL GRAMM, Texas
RICHARD C. SHELBY, Alabama
ROBERT F. BENNETT, Utah
WAYNE ALLARD, Colorado
MICHAEL B. ENZI, Wyoming
CHUCK HAGEL, Nebraska
RICK SANTORUM, Pennsylvania
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN ENSIGN, Nevada

STEVEN B. HARRIS, *Staff Director and Chief Counsel*
WAYNE A. ABERNATHY, *Republican Staff Director*
MARTIN J. GRUENBERG, *Senior Counsel*
THOMAS LOO, *Republican Senior Economist*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE E. WHITTLE, *Editor*

C O N T E N T S

WEDNESDAY, MAY 1, 2002

We have a clear opportunity to do this in the IMF based on very explicit surveillance criteria. All we have to do is ask for a consultation to say that the others should stop their currency manipulation. We have never done that.

There is even an article in the GATT and the World Trade Organization, I believe Article XII, along the same lines. We have never thought seriously about that, either.

We should take steps, both through bilateral consultations, and within the IMF context in a more formal way, to try, particularly with East Asians including Japan and China to stop further currency manipulation, which distorts exchange rates from what markets would determine.

And for China, finally, the bilateral consultations should be a very high priority. We have a mutual interest in reducing the very lopsided, 5:1 trade imbalance, with $100 billion U.S. imports and only $20 billion exports, last year, and we should begin with the question—why is the bilateral trade so imbalanced?

We should request, clearly, of China, that the central bank stop buying dollars at $50 billion a year, and that they bring their exchange rate up by 10 percent, 20 percent, or whatever is a reasonable first step.

The longer-term transition of China to a fully convertible floating rate relationship with the dollar should also be discussed. We should look at this seriously because that is what I believe the longer-term objective should be. It is a mutual interest and it is the best way to avoid trade conflict from further unjustified Chinese currency manipulation.

Thank you, Mr. Chairman.

Chairman SARBANES. Thank you very much.

Our concluding panelist is Steve Hanke, a Professor of Applied Economics at Johns Hopkins University.

Mr. Hanke.

STATEMENT OF STEVE H. HANKE
PROFESSOR OF APPLIED ECONOMICS
JOHNS HOPKINS UNIVERSITY

Mr. HANKE. Thank you, Mr. Chairman, Senator Gramm.

Let me just briefly make a few points that pick up on some of the things that have been discussed in the morning session. My remarks will highlight points that are developed in my prepared statement.

Chairman SARBANES. We will include your full prepared statement in the record and we appreciate your condensing it.

Mr. HANKE. Thank you, Mr. Chairman.

We have hearings in which "exchange rate policy" is stated, as one of the phrases in the title of the hearings themselves. And interestingly enough, if you look at the U.S. evolution of exchange rate policy in general, we really did not have any coherent policy stated in the United States, until 1999, when Secretary Rubin, in April, articulated the policy.

Then Summers followed in September 1999, after he was appointed Secretary, and Stanley Fischer at the IMF weighed in with essentially the same conclusion in January 2001.

Now what did they say about exchange rate policy and why are their statements important?

There are three generic types of exchange rates—a floating rate, which Rubin and company said was suitable for the United States. And that is a rate in which the exchange rate itself is on autopilot. You only have a monetary policy. You have no exchange rate policy under a floating exchange rate regime.

At the other extreme, you have an absolutely fixed exchange rate regime in which an exchange rate policy exists, but monetary policy is on autopilot. And that would be things like orthodox currency boards or dollarized systems.

Rubin, Summers, and Fischer came to the conclusion that I think all economists have come to, and that is, in a world of mobile capital and free capital flows, those two extreme free-market, automatic systems are desirable. And everything else in between is undesirable.

Now what is in the middle?

A pegged-type system is in the middle. For example, Secretary O'Neill mentioned that China has a soft peg. Well, they do have a soft peg. And the reason the thing doesn't blow apart is that China has extremely rigorous capital controls—the capital account is completely controlled.

So those are the three systems and as you can see, as a matter of principle, the Chinese system would be undesirable, according to Rubin, Summers, Fischer and most economists, certainly the major consensus.

What does this have to do with the hearings?

Well, it has a couple of things to do with the hearings. The Bush Administration has never gotten around to articulating and reaffirming what Rubin and Summers did. And Krueger has never reaffirmed what Fischer did. So, we need some clarity. I think you should push Secretary O'Neill to come forward with some clarity on the U.S. broad policy position.

For the United States, we accept floating. Now that has some implications, especially for the strong dollar rhetoric. Our exchange rate policy is a floating exchange rate. It is not a strong dollar policy. A strong dollar policy is nothing but rhetoric and absolute economic nonsense. It doesn't mean anything in economic terms. The dollar's value is determined in the market and under a floating exchange rate, that determination is on autopilot.

So, I would agree with Jerry and Fred on this thing. Any adjective for the dollar—whether it is strong, sound, or weak—doesn't mean anything if you accept free capital mobility and a floating exchange rate because the dollar's price is simply on autopilot.

I think, Mr. Chairman, I see a red light on your little gauge.

Chairman SARBANES. Why don't you go ahead if you have a few more points you want to make.

Mr. HANKE. This rhetorical point would be one thing on which, oddly enough, Fred, we are in agreement.

Now let me mention something on which Fred and I probably would not agree. The world is already very much unofficially dollarized. That means that 90 percent of all foreign exchange transactions have the dollar on one side of the trade. Ninety percent of all commodities traded in the world are invoiced in dollars.

So, you do not have this so-called exchange rate problem that we have been discussing. They are buying and selling in dollars and invoicing in dollars.

Now, in terms of manufactured goods, Mr. Chairman, the issue gets a little bit tricky to sort out and make generalizations. But I can tell you that about 35 percent of exports from Japan are actually invoiced in dollars. They are dollarized. And almost 65 percent of all the imports going into Japan are dollarized.

The point here is, if you really want to get around these problems with exchange rates, Fred, and the competitiveness, uncompetitiveness, competitive devaluations and so forth, what we should do is try to encourage the official dollarization of most smaller countries—I am not suggesting Japan or Euroland because that would put them in the same currency bloc as the United States and we would not have to spend much time with these conversations because everyone would be buying and selling and invoicing and dealing in dollars. I would point out that, generally, the U.S. dollar can be characterized as a vehicle currency in the world that is truly dominant in staggering ways.

We had an earlier conversation about dollar reserves held at the Chinese central bank, as well as the Bank of Japan and changes in those. About 66 percent of all the foreign reserves held at central banks in the world are in dollars or assets denominated in dollars. So, I think if we go after every central bank using dollars in this way, in an official way, we have a lot of villains out there that we are going to have to go after, just not Japan and China.

Mr. Chairman, I appreciate your letting me overindulge on time. I think I have made some of the main points I wanted to make, in any case. Thank you for giving me the extra time.

Chairman SARBANES. Thank you very much, Professor Hanke.

I might mention that the Committee has received a number of letters from across the country from various manufacturers and producers with respect to this hearing, expressing their viewpoint which has been expressed by some of our earlier panelists here today, which we will place in the hearing record. What is the response to this dollarization statement that Professor Hanke made?

Mr. JASINOWSKI. I think it makes general sense. I do not know how far it can go in terms of dealing with the central problem of the strong dollar policy being advocated by the Treasury. But it does, I think, help on the demand side with respect to dollars. And therefore, I think it is good in that sense. It is also good in the sense of the dollar currency being a more stable currency than most. So, I would initially be positive toward that.

Chairman SARBANES. As I understand it, the assertion is that a good part of the Japanese trade is invoiced in dollars. I take it you then draw from that the conclusion that the exchange rate difference is not affecting the trade balance. Is that right?

Mr. BERGSTEN. Mr. Chairman, let me take a stab at that.

In this context, dollarization is a narcotic because, with most of the world's trade financed in dollars and with most of the reserves in central banks held in dollars it is very easy for us to finance these big deficits relative to other countries whose currencies are not widely used in international finance.