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International Trade and Manufacturing Policies for the 21st Century
Yes, We Can Build Consensus

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Abstract

American manufacturing has suffered a major decline in international competitiveness over the years since the first Oil Crisis in the 1970s. This decline, which is driving the offshoring of jobs and production lines to low-wage foreign countries, is central to America's overarching economic problem -- excessive trade deficits that have been accumulating for nearly forty years with no end in sight.

As a result, America now carries the largest stock of foreign debt in the world. Furthermore, manufacturing's declining ability to compete with foreign imports in domestic markets and with foreign producers in export markets has contributed to America's unemployment and income inequality, as well as to financial market volatility and instability.

Although America's trade deficits and manufacturing decline relative to countries like China are closely linked, neither problem is causing the other. Instead, both are the result of the serious overvaluation of the U.S. dollar.

The dollar's overvaluation is driven largely by: (a) the failure of America's international monetary policies to keep pace with dramatic changes in the global economy during the past forty years, and (b) the fact that, because the U.S. dollar is the world's main reserve currency, America is more exposed than any other country to the impact of a tectonic shift in the way exchange rates are determined.

Following a brief summary of reasons that American manufacturing has lost its competitiveness and that trade deficits have become so large, the paper summarizes the pros and cons of the ways America could increase its international competitiveness and reduce its trade deficits. The paper finds that the key reason for declining competitiveness and rising deficits is the flood of foreign capital into America, starting in the 1970s, to take advantage of America's financial markets. This has caused the dollar to become seriously overvalued because (a) the demand for dollars and dollar-based assets has increased the dollar's market exchange rate; (b) excessive capital inflows have driven up domestic prices, making American goods more expensive and less competitive, and (c) the market exchange rate has not adjusted sufficiently to restore balanced trade and international competitiveness for American manufacturing.

Based on this analysis, the paper finds that the best way to restore competitiveness and reduce external deficits would be to moderate the inflow of foreign capital coming into U.S. markets so that the present glut of capital no longer distorts the American economy.

The paper then examines a new approach to moderating capital inflows that appears to have the best prospects for success, namely a small "market access charge" (MAC) on capital inflows. This charge would be paid by foreign investors who want to exploit America's financial markets when they are already overheated, causing the dollar's overvaluation as indicated by a trade deficit that is rising relative to GDP.

After describing the legal and economic foundations for the MAC and how this simple mechanism would work, the paper analyzes potential headwinds to the policy's implementation and how likely issues can be resolved. It also examines the MAC's expected benefits for stakeholders across the economy, benefits that will create tailwinds that should allow the MAC to become the core of a consensus-based manufacturing and trade policy for America in the 21st century.

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Introduction

Why can't Americans earn as much producing exports as they are spending on imports? Why isn't America's manufacturing industry providing what it provided for years -- a solid foundation for a thriving American middle class, quality goods that could sell at internationally competitive prices, and profits that stimulated and financed investments in ever-higher levels of productivity and in ever-rising prosperity for all Americans?

Unfortunately, the condition of America's trade and manufacturing has deteriorated seriously since the mid-1970s. The gap between imports and exports last year was equal to about three percent of GDP which, according to the International Trade Administration (ITA), equates to the loss of over 3 million jobs, and given the sharp recent appreciation of the dollar, appears to be headed back towards the nearly six percent of GDP level we saw in 2006.

In stark contrast to what has been happening in our major trading partners – China, Germany, Japan and Mexico, America's manufactured exports have fallen from over 80 percent of total U.S. exports between 1997 and 2004 to only 62 percent in 2014 – at which time the ratio was about 80 percent in Mexico and 94 percent in China.

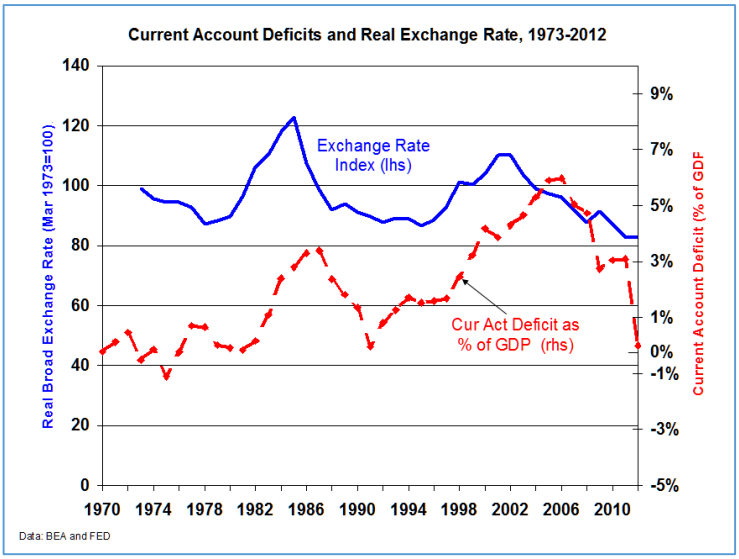
Furthermore, the share of advanced technology products (ATPs) in total merchandise exports has fallen by almost half – from 34 percent in 2000 to less than 18 percent in 2012-13. In stark contrast, the share of ATPs in total merchandise exports for China rose from 19 percent of exports in 2000 to over 30 percent in 2004-2006, and even though the share has now retreated to around 27 percent, this is still far higher than the 18 percent for the U.S.[1]

We know America's cumulative trade deficits have been piling up year after year, and that our country, which was the world's largest creditor after World War II, is now the world's largest debtor. Its net international investment position (NIIP) is a negative $7.0 trillion.[2] America has run up debts to foreigners equal to about $90,000 for a family of four because we have been acting like the inhabitants of Warren Buffett's famous Squanderville, living beyond our means as though there were no tomorrow.[3]

Throughout the world, the main cause of trade deficits is an overvalued national currency that makes imports too cheap and exports too expensive. This is exactly what has happened to the United States

(Fig 1). We must stop borrowing billions of dollars every year from countries like China so that we can pay them to produce goods for us that we could produce for ourselves. Not only that. We could produce a major share of these goods *at internationally competitive prices* if the dollar were at its equilibrium exchange rate – the "fair value" that would balance America's total trade with the rest of the world.

Fig. 1. External deficits rise when dollar is overvalued.



Nearly three quarters of America's trade deficit is caused by the deficit in manufactured goods.[4] Despite all the hype about services being America's salvation for the future, their share in total exports has only risen by 2 percentage points in the past twenty-five years – from 28 percent to 30 percent.[5] Furthermore, given the low wage rates and increasingly high quality of education and technology in emerging market countries, U.S. exports of services are not suddenly going to boom.[6] In fact, services on a net basis are likely to shrink as we import more services ranging from call centers to accounting and medical assistance – often electronically. Nor will agricultural exports do the trick – today they account for less than five percent of total U.S. merchandise exports on average, and countries zealously protect their farmers from import competition.

In short, if we are going to stop accumulating debts to foreigners, debts that our children will have to deal with, and if we are going to realize the American dream of shared prosperity for all, we must put millions of Americans back to work producing internationally competitive goods. We need to fix manufacturing and all the sectors that feed into it including education, R&D, infrastructure, and health.[7] *We need to make manufacturing so internationally competitive that Americans can once again earn as much producing exports as they spend on imports.* If we don't change our trade and manufacturing policies dramatically to make them consistent with the realities of the 21st century, the future facing our children will be bleak indeed.

This note focuses on the questions America must answer as it seeks consensus on manufacturing and trade policies for the 21st century:

- What are the pros and cons of the policy options currently on the table for restoring American manufacturing's international competitiveness?
- How would the Market Access Charge (MAC) that is proposed in this paper work – and why would it work better than any of the options already under consideration?
- What headwinds to implementation would have to be overcome to implement a MAC, and what benefits would a MAC offer to the key stakeholder groups in America – benefits that would provide tailwinds making approval and implementation of a MAC easier?

A. Restoring International Competitiveness with a Market Access Charge

Trade Law Options for Restoring Competitiveness

Traditional "import relief" measures and their problems are all well known, so I simply list them here.

- Quotas, general tariffs, and non-tariff barriers. Their use is generally prohibited or restricted by international law; because they tend to focus on specific products, and often only those from specific countries, they create a very uneven playing field; they provide no stimulus to exports; and they do nothing to fix the dollar's overvaluation –the primal cause of most economic problems facing America today.
- Anti-dumping and countervailing duties. These play an important role in the fight against foreign dumping and subsidization of specific products exported to the United States. However, they provide no stimulus to America's own exports; their coverage of imports is highly limited – only about 2 percent of U.S. imports are covered;[8] the investigation process required by WTO to prove damage is often too slow to provide timely import relief; and the duties do nothing to fix the dollar's fundamental overvaluation.
- Currency manipulation taxes. Most trade law proposals that Congress has considered include currency manipulation taxes (CMTs) to fight currency manipulation. CMTs are surcharges based on estimates of the amount by which the target country's currency is "undervalued" by "currency manipulation." The resulting estimated subsidy rate caused by currency manipulation would then be added to existing antidumping and countervailing duties.

  If ways could be found to get reliable estimates of the degree of undervaluation for targeted

countries, good economic arguments do exist for adding CMTs to antidumping and countervailing duties on specific products. However, CMTs provide little hope of providing the relief needed by American manufacturing for the following reasons:

- The coverage of the antidumping and countervailing duties to which CMTs would be attached is so limited that they would have no meaningful impact on correcting the distortions caused by the overvalued dollar.[9]
- Measuring "undervaluation" in a defensible manner is virtually impossible as shown by IMF analysis.[10]
- CMTs can only be applied to countries officially labeled as "currency manipulators", and the labeling process generally involves serious problems. Under IMF rules, for example, proving that a country is a "manipulator" requires proving that its *intent* is to gain international competitive advantage, which is difficult, and labeling a country like China as a "manipulator" risks serious political blowback.
- There is absolutely no economic basis for assuming that China's moving the yuan to its "fair value" would fix U.S. trade deficits. America gets less than 20 percent of its imports from China, and if CMTs are used to keep out tires from China, for example, similar tires can easily come in from other low-wage countries like Vietnam that have not been labeled as manipulators.

- Countervailing Currency Manipulation. Some have suggested that America should use tit-for-tat currency intervention to fight currency manipulation (Bergsten and Gagnon 2012). For example, if China buys a billion dollars' worth of assets with yuan, America should buy a billion dollars' worth of yuan with dollars to counterbalance the impact. Even announcing the *intent* to do this would probably run afoul of IMF rules, and actually doing so would constitute nothing less than an open declaration of a currency war with no "exit strategy." It would only produce a vicious cycle from which everyone emerges a loser.
- Deflate Domestic Prices. America's key problem today is that domestic prices, when translated into foreign prices at the prevailing bilateral exchange rates for the dollar, make our exports too expensive and make foreign imports too cheap. Under the gold standard in its various forms, countries restored competitiveness without changing their gold parity rate by deflating domestic

prices. Taking this route to competitiveness in today's world where falling prices are one of the world's greatest concerns would be economic suicide – leading America, and the world, down the rat hole of recession and depression.

- Change Exchange Rate. At this point you may be asking, if the problem is the overvalued dollar, why not simply fix the exchange rate rather than thinking about all these options that clearly won't work? I fully agree. The nominal exchange rate for the dollar must change. But how? Three classic routes exist – (a) adjustment by fiat, (b) adjustment by market intervention, or (c) depend on trade in free private markets to adjust find the equilibrium rate.

Unfortunately, none of the options currently being discussed will solve America's competitiveness problems. First, setting rates by fiat does not work well in the modern world. In the past, many countries set exchange rates by fiat, but had to give up trying to defend the rate because of the costs involved. Fiat-based rates are particularly costly when foreign exchange reserves must be spent to prop up rates, but as the Swiss recently discovered, preventing a rate from rising above fiat-based levels can also be risky, requiring the purchase of foreign currencies that are likely to devalue relative to the national currency when it finally rises. [11]

Second, although market intervention worked during the Bretton Woods era, bureaucrats had to decide on an appropriate exchange rate, and as the world became increasingly complex, this approach failed, contributing to the collapse of the Bretton Woods system in the early 1970s.

Third, letting markets set exchange rates makes a lot of sense in theory, and this is basically what the U.S. has been doing for years. Only one problem: it doesn't work. If it did, America today would have balanced trade and a competitive manufacturing sector. We don't. Clearly something is wrong with depending on the market to set the dollar's exchange rate at its fair value.

What is "wrong" is that the world has changed dramatically. For centuries, exchange rates were determined by the demand and supply of exports and imports. If a country bought more imports than it sold as exports, it paid the difference with its domestic currency. If substantial trade deficits continued for too long, other countries received more of the country's currency than they wanted and the exchange rate would fall. This would make the country's exports more competitive and imports more expensive, thereby restoring balanced trade.

This no longer happens, especially for the dollar, ***because the dollar's exchange rate is now determined largely by trade in dollars and dollar-based assets, not by trade in real goods and services.*** As a result, any connection between the dollar's exchange rate and the rate needed to balance America's current account trade in goods and services is basically an accident.

The world in general, and America in particular, needs to restore the link between the exchange rate and balanced trade in real goods and services. That is exactly what the proposed Market Access Charge (MAC) is designed to do.

Conceptual Basis for a Market Access Charge

The Market Access Charge (MAC) is based on the following facts:

(a) American manufacturing has lost competitiveness at home and abroad because the dollar is overvalued. (See Annex A for definitions of this and other terms used by economists.)

(b) The dollar is overvalued because foreign demand for dollars and dollar-based assets has driven the dollar's exchange rate far above its "fair value" or "equilibrium rate," the level that would balance imports and exports.

(c) The demand for dollars and dollar-based assets largely reflects the desire of foreign investors to extract profits from America's financial markets, which are arguably the deepest, safest, and most liquid in the world.

(d) As in all situations where demand and supply are not balanced, when the foreign demand for dollars and dollar-based assets exceeds the supply of such assets in America's financial markets, the dollar's price is driven up. Hence the overvaluation.

(e) Since profit is a motive for much of the flow of foreign investment into U.S. financial markets, reducing the profit margin of investing here in dollars rather than somewhere else in another currency can reduce these exchange-rate distorting foreign capital inflows.[12]

(f) As we know from the massive transfer of capital to emerging markets that took place when the Fed began lowering U.S. interest rates with quantitative easing (QE) – and the sharp reversal of these flows during the "Taper Tantrum" when the Fed hinted that it might be thinking about starting to raise U.S. interest rates by slowing QE purchases, international capital flows are highly sensitive to small changes in interest rates and thus profit margins.

(g) Imposing a Market Access Charge on foreign investors seeking to take advantage of U.S. financial markets would raise the cost of investing in the United States by reducing the net interest rate or profit that such investors would receive compared to investing elsewhere.

(h) Raising prices to help balance the demand with the supply of dollars and dollar-based assets is simply another form of "peak load pricing."

Peak load pricing is used throughout the world by both private and public sector entities to balance demand and supply. For example, cell phone companies charge more for calls during the business day than in evenings and on weekends. Resorts charge more for a room during peak seasons than in off-peak seasons. And cities like London, Singapore and Stockholm impose special charges for driving in congested city centers during peak traffic hours. If done right, peak load pricing is absolutely legal, well-founded in economic theory, market-based, non-discriminatory, automatic, and free from the risks of distortion and corruption that bedevil other mechanisms such as tariffs and quantitative restrictions.

How would a MAC fix the dollar's exchange rate?

The MAC, which was designed on the basis of the author's nearly five decades of work on trade and manufacturing policy in countries around the world, is intellectually sound and administratively feasible. In outline form, the Market Access Charge (MAC) would work as follows:

Summary of the Mechanism

A MAC would impose a small, one-time charge on all incoming financial flows. Once the MAC fee had been paid, the foreign investor would be given "national treatment" and could use the money within the United States just as any U.S. resident could, subject of course to a Committee on Foreign Investment in the U.S. (CFIUS) review if required.[13] The MAC charge rate, which would start at zero, would be reviewed twice per year and adjusted according to a fixed, pre-announced formula based on the size of the U.S. trade deficit as a percentage of GDP. (Annex B provides a simple numerical example of how this would work.)

Legal Mandate

A MAC could be put into place on the basis of an executive order, a law passed by Congress, a regional agreement, or an international treaty. Given the many advantages of multilateral cooperation, an international or regional treaty would be ideal. A number of countries have either introduced a system somewhat similar to the MAC in the past or have considered this approach. Consequently, a multi-national approach might be feasible.[14] In fact, the best possible situation would be for all countries to

introduce a MAC. In contrast to most trade-related policies like tariffs, there is virtually no risk that a MAC could ever be used to gain an unfair mercantilist advantage over another country. Why? Because a MAC can be set to a non-zero rate only when a country has a trade *deficit*.

However, given that establishing a multi-national consensus on a MAC-like treaty would probably require years of work, the best solution for America in the short run would be a law passed by Congress and signed by the President. Since a MAC is both highly market-based, highly focused on assuring good jobs for Americans, and designed to enhance the profitability of American manufacturing, a MAC law should garner support from both sides of the aisle.

If passing a law in Congress proved difficult, the President could even implement a MAC with an executive order because, under the International Emergency Economic Powers Act of 1977, the President has broad authority to restrict foreign ownership of US assets in cases of "unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the… economy of the United States."[15] America clearly faces such a threat today. (The legality of a MAC under existing national and international laws and agreements is discussed below.)

MAC Trigger

- A U.S. trade deficit that exceeds one percent of GDP on average over the past 12 months would trigger a non-zero MAC rate.
- Using the U.S. trade deficit, expressed as a percentage of GDP as the trigger for the MAC, is far superior to the triggers used by alternatives such as CMTs. The trade deficit as a share of GDP is a well-known, empirically based indicator that is published monthly. In contrast, approaches based on estimates of currency manipulation require ad hoc calculations using various formulas, each of which is based on highly subjective assumptions and is subject to wide variation in terms of results.

MAC Rate

- The MAC rate, which would be adjusted on a six-monthly basis, would depend on the severity of the trade deficit.
- An initial non-zero rate would be triggered when the trade deficit published by the Bureau of Economic Analysis reached 1% of GDP.
- The initial charge would be 50 basis points or half of one percent of the value of the incoming foreign capital.

- The rate would rise or fall in line with the trade deficit according to an adjustment factor set by law. For example, if the adjustment factor is set at 50% (an elasticity of 0.5), a half-percent increase in the trade deficit would increase the MAC rate by one quarter of a percent (see Annex B for further details).
- As the trade deficit began to fall, the MAC rate would begin to decline in the same manner, returning to zero once the trade deficit had dropped below a very manageable one percent of GDP for the previous 12 months.

Flows Subject to the MAC charge

- All capital inflows would be subject to the same MAC rate.
- Applying the same rate to all foreign capital inflows avoids the problems of evasion, corruption, favoritism and economic distortions that other countries like Brazil have encountered with similar capital inflow charges when they tried to discriminate between "good" and "bad" capital inflows.
- A common rate for all inflows automatically discourages short-term speculative in-and-out flows because the MAC is charged each time foreign capital enters the U.S. Conversely, a common MAC rate would be inconsequential for foreign direct investors because once such investment has come in, it stays for a long time and generally has a much higher total return than speculative portfolio investments. [16]

Administration

The MAC would be collected automatically and electronically by the computer systems of the six or seven U.S. gateway banks that handle most of America's cross-border financial transactions.[17] Under contract, these international banks would also handle cross border transactions for other banks as needed.

Foreign investors seeking access to US financial markets would pay any Market Access Charge that is due. *The MAC is not a tax on Americans*.

MAC charges collected by the gateway banks would be transferred electronically to the U.S. Treasury upon receipt. To prevent the Government's becoming "addicted" to MAC revenues to finance normal budgetary programs, MAC revenues would be placed in a separate account. Funds in this account could be used only for improving the global competitiveness of American enterprises and workers, or for reducing the burden of U.S. Government debt held by foreign countries.

Using MAC revenues to reduce the burden of government debt held abroad should help make the MAC concept highly attractive on both sides of the aisle in Congress and to a majority of the American people for the following reasons:

a) America's relatively high level of government debt is a hot-button issue for many Americans, so any form of reduction would be welcome.

b) The explosion since 1970 in the share of public debt held by foreign lenders is of particular concern because, unlike money borrowed domestically, money borrowed from abroad acts like high powered money "printed" by the Fed, increasing the risks of inflation and financial crises, and reducing the competitiveness of American manufacturing.

c) Using MAC revenues to buy back or retire foreign-held government debt would be a mild form of countervailing currency manipulation. Buying back U.S. treasuries held by China, for example, would in a sense "countervail" China's original purchase of the treasuries, but without the risk of triggering an open-ended currency war because we would simply be recovering our own assets.[18]

d) Since debt reduction is not a normal expenditure obligation in the budget, using MAC monies to reduce foreign-held U.S. government debt would be consistent with not becoming dependent on such monies to finance ordinary budget expenditures.

e) Reducing the total stock of federal government debt would reduce the budgetary costs of paying interest on the public debt, thereby offsetting part or all of the cost of any higher interest rates that introducing a MAC could cause by reducing the inflow of capital from abroad.

Legality of a MAC

World Trade Organization/General Agreement on Tariffs and Trade (WTO/GATT)

Unlike initiatives designed to fight currency manipulation by imposing additional import duties through currency-based surcharges to antidumping and countervailing duties – initiatives that might well be challenged through the WTO/GATT dispute settlement process, the WTO agreements provide no basis for challenging a MAC. As Larry Summers and Ed Balls said in their ***Report of the Commission on Inclusive Prosperity***, *"… WTO rules pertaining to exchange rates are inadequate to address the challenge of unfair advantage from skewed exchange rates. Thus, it is unsurprising that no WTO member country*

has ever brought a currency dispute to the body." [19] In practice, whenever any dispute involving exchange rates comes up, the WTO passes the issue on to the IMF.

International Monetary Fund (IMF)

The MAC is basically an international capital flows management tool related to exchange rates, and the IMF has relevant rules and views. Historically, the IMF would probably have objected to a MAC because of the organization's traditional position that the world is better off with absolutely free international movement of capital. However, the Articles of Agreement do not give the IMF any real jurisdiction over capital flows, and the staff's effort to obtain this from the Board after the Asian Crisis of 1997 was rejected.

The Asian Crisis, which many observers believe was caused by excessive international capital flows – including "hot money" that fled with the first sign of trouble – led the IMF to start reconsidering its views on international capital flows. During the years following the crisis, the IMF's position gradually evolved through a series of staff papers, a process that culminated in 2012 with a paper, *The Liberalization and Management of Capital Flows: An Institutional View."* [20] In this paper, the IMF acknowledges that, under certain circumstances where normal good economic policies were insufficient, capital flow management tools are a legitimate way to help restore domestic and foreign balances.

America clearly meets the criteria for needing to implement a capital flow management policy, and the MAC is designed to conform fully with the IMF criteria:

> *Transparent*: Unlike currency manipulation taxes (CMTs), which would be based on complex, unreliable calculations, the MAC is linked by a simple formula to the U.S. trade deficit as a share of GDP, a number that is published every month by the U.S. Government (Annex B). By looking at the law, anyone who can do simple arithmetic will be able to tell not only what the current rate is, but what it will be if the current trade balance trends continue for the next 12 months.
>
> *Targeted*: Unlike currency manipulation taxes, quotas, and other mechanisms discussed above, the MAC is clearly targeted on reducing America's overall trade deficit, and it is targeted on the primal source of these deficits – an excessive demand for dollars and dollar-based assets in U.S. financial markets.
>
> *Temporary*: The MAC provides the best of both worlds in terms of this criterion. It is temporary because the MAC rate will automatically go to zero when the trade deficit drops below one percent of GDP. At the same time, to avoid the problems faced by many countries that keep changing their import protection policies in the face of political pressures and vested interests, the MAC would be a permanent mechanism, one that would allow all exporters and importers to know exactly where they stand and what will happen if, after a period of relative stability, international financial markets go into another period of "irrational exuberance" or outright currency manipulation and the U.S. trade deficit again exceeds one percent of GDP.

Non-discriminatory: Unlike CMTs that would differ by country, product, and even producer, the MAC would apply equally to all foreign capital inflows regardless of ownership, origin, currency, intended duration, or declared purpose. This is the only way to be reasonably sure that the system will be transparent, free from corruption, cost-effective to operate, and that it will maximize economic efficiency by maintaining a level playing field for all.

Organization for Economic Cooperation and Development (OECD)

The *OECD Code* on capital flow measures is largely complementary to the IMF's Institutional View.[21] Consequently, since the MAC meets IMF criteria, it also meets OECD criteria.

U.S. Trade Law and Treaties

Reflecting the traditional separation of international trade and international finance and the fact that most U.S. law relevant to the rest of the world has focused on trade in goods and services, not on financial flows, U.S. trade law is basically silent on capital flows. The law coming closest to laying down rules regarding international capital flows may well be the "Omnibus Trade and Competitiveness Act of 1988."[22] The key analytical points in this law are still right on the mark, almost thirty years later:

1. "Capital flows between nations have become very large compared to trade flows ..."
2. "A more stable exchange rate for the dollar at a level consistent with a more appropriate and sustainable balance in the United States current account should be a major focus of national economic policy ...";
3. "Some major trading nations manipulate the value of their currencies…"; and
4. "Intervention by the United States in foreign exchange markets … could produce more orderly adjustment of foreign exchange markets."

The law requires Treasury to send Congress a twice-yearly report[23] in which Treasury must:

> "… consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. If the Secretary considers that such manipulation is occurring with respect to countries that (1) have material global current account surpluses; and (2) have significant bilateral trade surpluses with the United States, the Secretary of the Treasury shall take action to initiate negotiations with such foreign countries on an expedited basis, in the International Monetary Fund or bilaterally, for the purpose of ensuring that such countries regularly and promptly adjust the rate of exchange between their currencies and the United States dollar to permit effective balance of payments adjustments and to eliminate the unfair advantage".

Despite seemingly overwhelming evidence that countries like China continued to manipulate their currencies following the passage of the bill in 1988, no meaningful action against such manipulation has ever been taken. Thus it is clear that we need a better tool than the 2008 Omnibus Trade Bill to combat currency misalignment if America is to prosper in the 21st century. The MAC appears to be fully consistent with the spirit of the 1988 law – and far more likely to attain its objectives.

America's bilateral and multilateral agreements and treaties are the other area of U.S. law that needs to be considered. A sampling of these documents, which follow a fairly standard format, indicates that they focus almost exclusively on current account trade in real goods and services and say virtually nothing about capital flows. They should pose no problem to the passage of a MAC. [24]

Why a MAC would work better than any other option.

For the following reasons, a Market Access Charge would be better than any of the other options for balancing trade that are currently on the table. These include taxes on currency manipulation, commitments regarding currency non-manipulation in connection with free trade agreements, and countervailing currency manipulation.

1. ***A MAC focuses on fixing the real problem, not just the symptoms:*** A MAC would focus directly on moderating the excessive foreign capital inflows that cause the dollar's overvaluation. This overvaluation has reduced our manufacturing sector's international competitiveness, leading to the loss of manufacturing jobs and profits. It has also contributed to the loss of American production capacity, reducing America's national security. Approaches other than the MAC deal only with symptoms, doing virtually nothing to solve the underlying problem of the dollar's overvaluation.

2. ***A MAC stimulates <u>all</u> export products and protects <u>all</u> domestic production from imports.*** By focusing on restoring and maintaining a fair internationally competitive exchange rate for the dollar, a MAC would reduce or eliminate the "Overvalued Dollar Tax" that forces U.S. manufacturers to sell their products between ten and twenty percent cheaper to compete against imports in U.S. markets and with foreign producers in global export markets.[25]

3. ***A MAC stimulates exports to <u>all</u> countries and moderates imports from <u>all</u> countries.*** By restoring and maintaining an internationally competitive market exchange rate for the dollar rather than trying to badger individual countries to change their exchange rates, the MAC will improve America's balance of trade with <u>all</u> of its trading partners, not just the few that Congress and the President might decide to label as currency manipulators.

4. ***A MAC focuses on fixing America's own currency, not the currency of some other sovereign nation.*** Virtually all of the alternatives to the MAC assume that the American dollar is still the unchanging center of the global monetary universe, that all exchange rate adjustments must be made by other countries to the value of the U.S. dollar, and that fixing the exchange rates of

other countries will magically restore balanced trade for America. Instead of playing whack-a-mole with the currency manipulator of the month, the MAC assures that the U.S. dollar stays at its fair value and that its trade is balanced on a global basis – the only relevant measure of whether an exchange rate is at its fair value.

5. ***A MAC is under America's direct control and does not require approval or action by any other country.*** Most other options are based on the assumption that, if we beat up on China hard enough and long enough, China will change its exchange rate by enough to fix America's trade imbalances. This is nonsense.

6. ***A MAC is automatic:*** Under WTO/GATT rules, all other options require administrative action such as declaring a country to be a currency manipulator or approving antidumping and/or countervailing duties for *specific* products from *specific* producers in *specific* countries. We know from almost thirty years of experience with currency provisions in the Omnibus Trade Act of 1988[26] that such provisions are rarely effective because the Administration and/or Congress usually finds a reason that a country should not be declared a currency manipulator – even if the bulk of evidence in the Treasury's own report indicates that it is.[27] Likewise, as we know from complaints by American manufacturers, the import relief offered by America's antidumping and countervailing duty system is commonly too little, too late, and too costly.

In short, an automatic system like the MAC will be far superior to policies already under consideration in terms of results delivered to American manufacturers and to the American people.

B. Building Consensus Support for a MAC

Make no mistake about it. Despite the obvious, objective, and easily explained advantages of a MAC over the other policy alternatives currently being discussed to improve the international competitiveness of American manufacturing and to restore the millions of domestic jobs lost to foreign workers, building the consensus needed to achieve approval and implementation of a MAC will require a lot of work because it represents a rather radical departure from traditional policies that focus primarily on reducing imports and on blaming someone else for our own problems..

The MAC proposal faces serious headwinds, most of which are myths driven by firmly held beliefs that may have been valid in centuries past, but are no longer true today. Many of these beliefs are deeply entrenched, but we *can* reach consensus on policies designed to return American trade and industry to robust health in the 21st century if we address these beliefs in an open, factual manner. Despite the

inevitable headwinds, reaching consensus will be made easier by the fact that key stakeholder groups throughout America – families, businesses, and the government – will all benefit from a MAC.

Potential MAC Headwinds – Myths from the Past

The key myths that are likely to create headwinds against MAC-like reforms include the following:

- **Exchange Rate Determination**

Myth: Exchange rates are determined by the supply and demand for goods and services traded on the current account of the balance of payments. Trusting the market is the best possible way to assure that exchange rates are correct. Government intervention is neither needed nor desirable.

Reality: Exchange rates today are determined largely by capital/financial account trade in financial assets, not by current account trade in real goods and services.[28] This is especially true for dominant reserve currencies like the U.S. dollar. Today, any similarity between the U.S. dollar rates set in international capital markets and the rates needed to balance America's current account are rare and accidental – as proven by America's roughly 40 years of trade deficits.

MAC: Implementing a MAC would provide the world with a new mechanism for determining exchange rates that is linked directly to current account balances and thus to balanced trade.

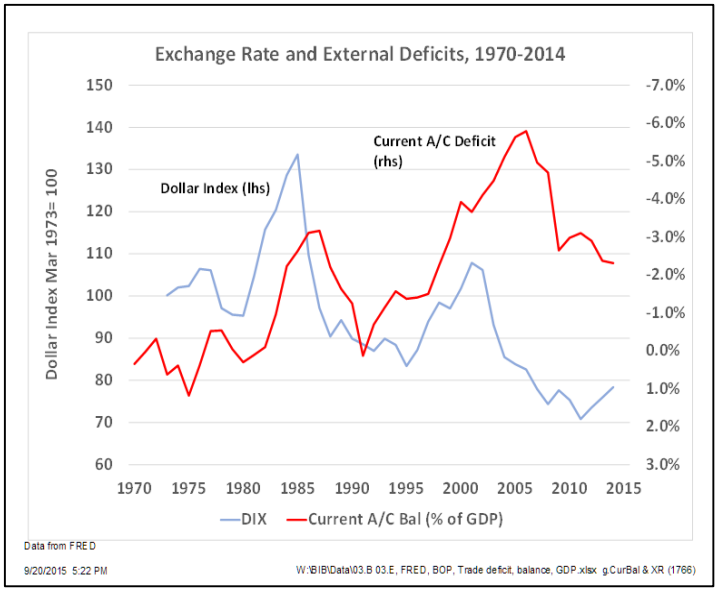
- **International Capital Mobility**

Myth: International capital mobility must be unfettered to maximize growth.

Reality: Once upon a time when very few countries had surplus capital and many were starved for capital, totally free international capital mobility made a lot of sense because this helped assure that scarce capital resources were used where they would earn the highest rate of return. Today, however, the world is so awash with excess capital that it floats like a toxic cloud from one crisis to the next – from the OPEC oil crises of the 1970s and early 1980s, to the Latin American debt crises of the mid-to-late 1980s, to Japan's financial crisis in 1989 that led to its Lost Decade(s), to the Asian Crisis of 1997, to America's Dot Com bubble, and on to America's Sub-Prime Mortgage Crisis in the first decade of this century, a crisis that then spread throughout the world as the Great Recession.

From the beginning of the Dot Com bubble to the Lehman Brothers collapse, this toxic cloud of capital caused an explosion of credit outstanding in America, leading to the dollar's overvaluation, high external deficits, and declining economic growth. (Figures 2 and 3). Even the IMF now admits that too much international capital mobility can be very damaging and supports capital flow management tools where needed.[29]

Fig. 2. The Overvalued Dollar Drives Trade Deficits



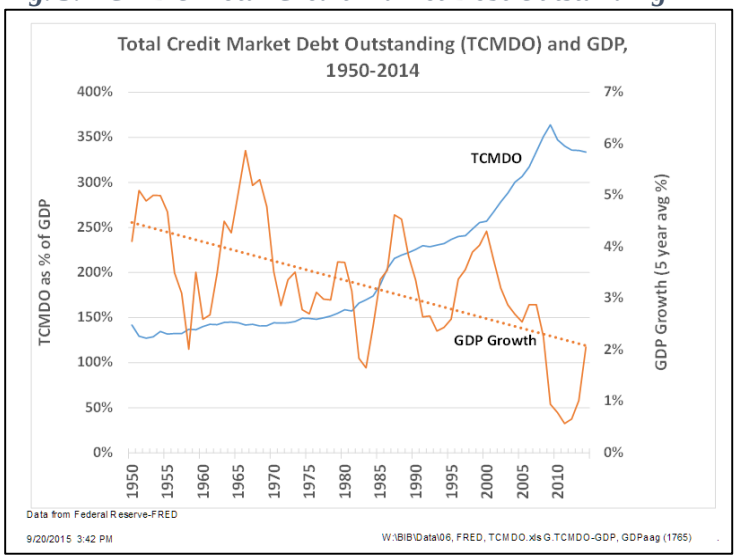
MAC: A MAC would be one of the best possible capital flow moderation mechanisms, one that would automatically operate when needed, then go onto standby mode when not.

- **Market Liquidity and Price Discovery**

Myth: The best financial markets are the largest and most liquid. They should be free from artificial government regulation so that price discovery can take place quickly.

Reality: Short-term traders love liquid markets because, by definition, liquidity allows them to move large blocks of capital in and out of speculative positions without significantly impacting market prices. Liquidity thus reduces the penalties for their risky behavior. A reasonable degree of financial liquidity is important, but the current level of market liquidity, where trillions of dollars are traded every day, looks more like financial dysentery than financial liquidity. Even the IMF admits that, after a certain point, additional liquidity hurts rather than helps growth.[30]

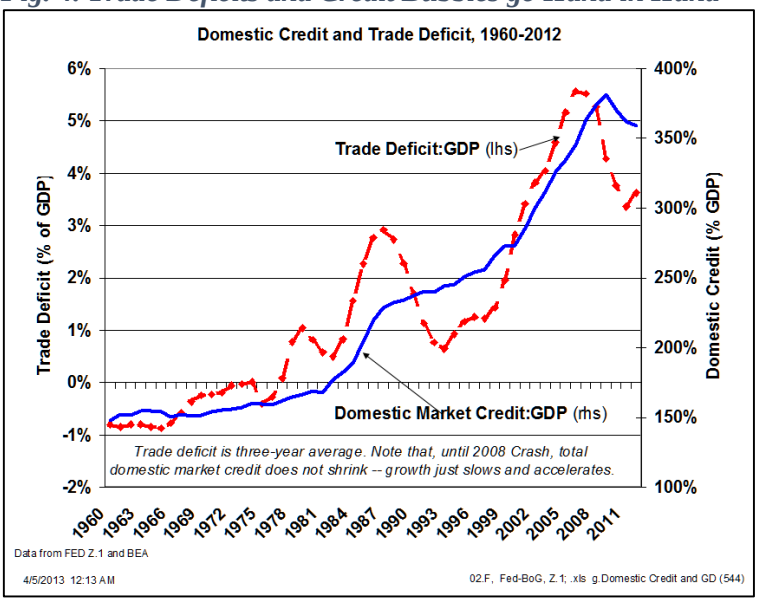
Fig. 3. TCMDO-Total Credit Market Debt Outstanding



Few people seem to realize the dramatic increase in the size of the domestic credit market and the amount of debt outstanding. As shown in Figure 4, domestic credit has exploded relative to GDP, rising from 150 percent to about 350 percent between the 1970s and today.

Given the impact of credit expansion on domestic prices and exchange rate competitiveness, it comes as no surprise that the trade deficit has ballooned at the same time. Meanwhile, the increase in credit, rather than stimulating real GDP growth, seems to be associated with its decline (Figure 5).

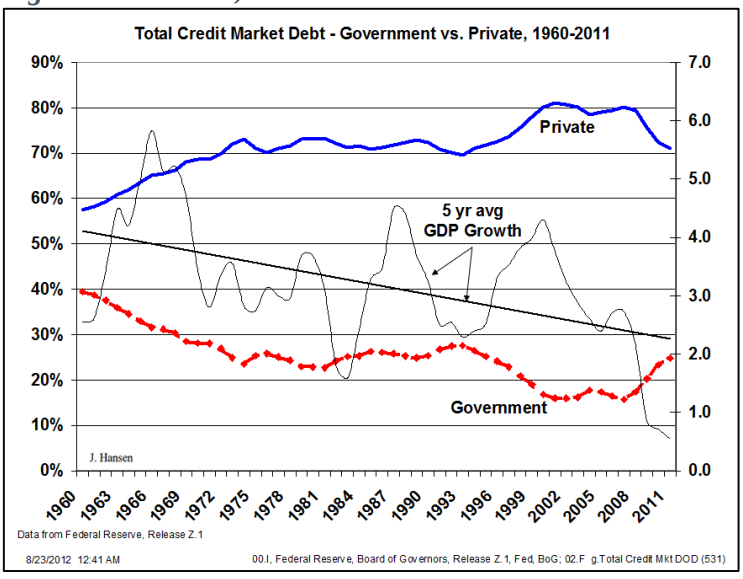
Fig. 4. Trade Deficits and Credit Bubbles go Hand in Hand



Furthermore, private sector debt, not government debt, has been the key factor driving the dramatic expansion of domestic credit and debt. In fact, the government's share of the total had dropped from 40 percent to about 15 percent prior to the crash of financial markets in 2008.

As for "*price discovery*," this term is generally used like pixie dust, scattered around in a knowing manner to squelch meaningful analysis and discussion. Serious investors have no desire to be in and out of markets every few seconds, exploiting tiny pricing differentials that only a computer can see. They have no need for a streaming ticker tape or a flickering Bloomberg to know where real value can be created.

Fig. 5. More Credit, Less Growth



MAC: A MAC would provide long-term investors a solid foundation for generating real, sustainable economic growth.

- **American Power over the Exchange Rate Policies of Foreign Countries**

Myth: America and the dollar are the center of the monetary universe. All other currencies revolve around the dollar and must adjust to the dollar's value, just as the sun revolved around the earth (at least until Galileo came along and upset the celestial apple cart). We can handle China and other "currency manipulators" just like we handled Germany and Japan in the 1985 Plaza Accord – force them to revalue their currencies against the almighty dollar. Heaven forbid that the dollar's value should be reduced! America is a hegemon, and it can tell upstart countries like China what to do.

Reality: How the world has changed! China, where per capita incomes were less than 4 percent of those in the United States in 1985 when the Plaza Accord was signed, now has a per capita income equal to almost 25 percent of that in the United States in purchasing power parity terms.[31] China is also larger than the United States in terms of exports, total trade turnover, and GDP measured in terms of what the yuan can purchase.[1]

Furthermore, China is a very proud country that already had over four thousand years of civilized history when the thirteen colonies declared their independence from King George. Henry Kissinger has told us that "as late as 1820 China produced over 30 percent of the world's GDP, an amount exceeding the GDP of Western Europe, Eastern Europe, and the United States combined" at the time.[32] China, which exports over 80% of its goods and services to countries other than the United States,[33] will never let America dictate its foreign trade and exchange rate policies.

MAC: If America wants assurance that its manufacturing sector can compete against China's, America will have to fix its own overvalued dollar. It cannot *make* the Chinese revalue the yuan. The Market Access Charge proposed here is the best way to fix the overvalued dollar.

In addition to implementing a policy such as the MAC, America should also enter into a free trade agreement with China and other countries to gain more leverage over the non-tariff barriers and intellectual property theft that cause such grief for American firms trying to operate and sell in those countries. But before doing this, America should introduce a MAC to assure that the dollar returns to

[1] Formally known as the purchasing power parity – the theoretical exchange rate that would, for example, make a Big Mac cost the same in China in yuan as it does in the United States in dollars when the currencies are compared at the purchasing power exchange rate.

and stays at its fair, internationally competitive value. A MAC will not keep China from playing fast and loose with international trade laws, but it will assure that the U.S. dollar exchange rate will adjust appropriately to any currency manipulation, thereby maintaining a rate that keeps our trade balanced regardless of what China does.

- **The Dollar's Reserve Currency Status and Exorbitant Privilege**

Myth: The dollar's position as the world's dominant reserve currency gives America exorbitant privileges such as the ability to borrow in its own currency and print money to repay the debts.

Reality: The benefits of the dollar's position as the world's dominant reserve currency are actually minimal. As noted in a report from the McKinsey Global Institute (MGI): [34]

> "There is a large downside to the United States acting as a magnet for the world's official reserves and liquid assets. Greater inflows of foreign capital mean that the dollar exchange rate is higher than it would be without reserve currency status."

In crisis years, America's net financial benefit, which MGI estimates to be 0.3 to 0.5 percent of America's GDP, can be smaller – even negative –as foreign capital floods into U.S. markets seeking safe haven. Furthermore, America's ability to borrow and repay in dollars creates an *exorbitant temptation* to politicians to kick the fiscal can down the road by borrowing rather than making tough decisions on budget priorities. Consequently, America's exorbitant "privilege" of printing the world's dominant reserve currency has become an exorbitant *cost*.

Based on the history of other major reserve currencies including the pound sterling, a currency can remain a reserve currency long after it ceases to be the *dominant* reserve currency. Work by the World Economic Forum[35] and others indicates that moving towards a system using a broader range of reserve currencies would be quite easy (especially in today's world where money can be moved and converted anywhere in the world at the touch of a button). Furthermore, multilateralization of global reserve currencies could be very advantageous.

MAC: The MAC would encourage foreign speculators and investors to invest in currencies other than the dollar when pressures on the dollar became excessive, as indicated by U.S. trade deficits exceeding one percent of GDP. A MAC could make a major contribution towards establishing a multi-country system of global reserve currencies, greatly reducing the problems created for America by the dollar's being the dominant world reserve currency.[36]

- **Deficits and Debt**

Myth: A major headwind myth facing introduction of a MAC is summarized nicely by Dan Griswold in a Cato publication: [37]

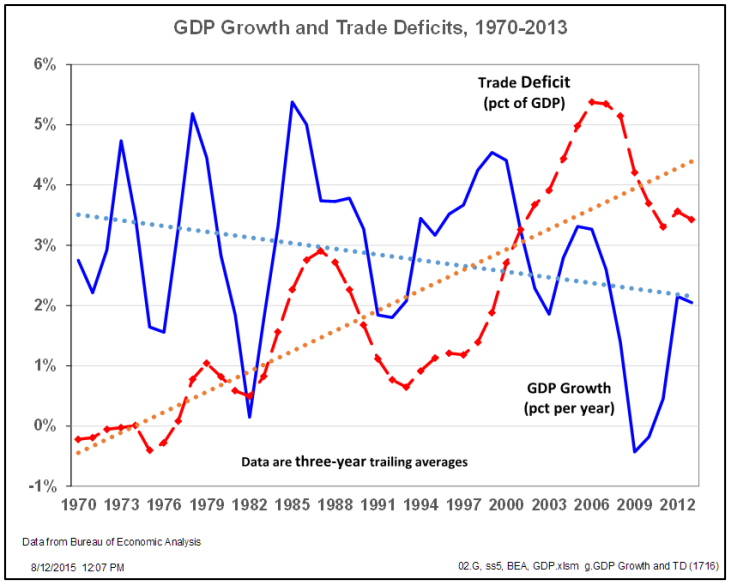
> **"**A trade deficit doesn't mean those dollars flowing abroad just disappear. They quickly return to the United States. If they are not used to buy our goods and services to export, they are used to buy American assets — Treasury bills, corporate stock and bonds, real estate and bank deposits. … The net surplus of foreign investment into the U.S. each year keeps long-term interest rates down, prevents the crowding out of private investment by government borrowing and promotes job creation through direct investment in U.S. factories and businesses."

When the trade deficit is rising, goes the myth, so is growth.

Reality: This is a particularly interesting myth because it is actually true in the short term but false in the long term. The extra consumption made possible by borrowing from abroad can give the American economy a temporary boost – much like caffeine or, worse yet, cocaine, can give a person a temporary boost. However, like people, economies become addicted to borrowing and debt, requiring more and more just to keep functioning even at reduced efficiency.

As seen in Figure 6, GDP growth and trade deficits move roughly in tandem on a year-to-year basis, but over the long haul, as shown by the regression-fitted trend lines, the dashed red trade deficit line has risen steadily over time, while the solid blue GDP growth line has trended downwards. In fact, over the past forty years, the world at large has become addicted to the stimulus provided by America's acting as the consumer, borrower, and debtor of last resort.

Fig. 6. Trade Deficits Cut Long-Term Growth



Furthermore, although some analysts would agree with Griswold's claim that foreign capital inflows create jobs through direct investment, the sad truth is that the share of direct investment declines sharply when a country's trade deficits increase. This can be seen not only in data on foreign capital inflows into the U.S., but into other countries as well.[38]

The converse is also true. Direct investment as a share of total foreign capital inflows has been much higher in countries like China with large trade surpluses than in countries like the U.S. with large trade deficits. The reason is easy to understand. Trade surpluses indicate the country's policies make manufacturing attractive for investors, while deficits indicate that the country's policies make manufacturing unattractive.

Despite the claims of Griswold and others, foreign trade deficits do matter, regardless of whether they are paid with outright borrowing or by the sale of national assets. Either way, such deficits indicate that we are living beyond our means, and to pay for the excess, we are mortgaging or even selling the family farm, something that will almost certainly hurt our children and grandchildren.

By the way, "farm" is not just a metaphor. When China bought Smithfield Foods in 2013 with $4.7 billion of the dollars it had accumulated from trade surpluses with the United States, it bought not only the processing facilities of the world's largest producer and processor of pork; it also bought 460 American farms that are now under foreign ownership and control, and it bought the right to contracts with another 2,100 American farms.[39] Thanks to this sale, China now owns or controls one of every four pigs in America.[40] Incidentally, China still has nearly $4 trillion in international reserves, so theoretically it could repeat the Smithfield purchase about 800 times over without borrowing a penny.

Debts and deficits clearly do matter, especially when they are owed to foreigners. Future generations will need to repay these debts. To accomplish this, they will have to take one or more of the following actions: (a) export more than they import, even though this would require reducing their standard of living; (b) print money to repay the debts, which are denominated largely in dollars, but this would risk inflation, more overvaluation of the dollar, and even less international competitiveness for American manufacturing; (c) roll over the loans, but this simply kicks the can further down the road—a shameless national Ponzi scheme that would hurt their children and grandchildren; (d) or they could default on the loans – but let's not even go there!

MAC: Implementing a MAC would provide the best possible exit from this conundrum. By linking the dollar's exchange rate to balanced trade, the MAC would gradually reduce the accumulation of new foreign debt to one percent per year or less. At this level, GDP would only have to grow by one percent per year to keep the debt burden at current levels relative to GDP, and GDP growth above one percent per year would gradually reduce the ratio of America's external debt to GDP.

- **A Strong Dollar and America's Best Interests**

Myth: U.S. Treasury Secretaries, including Robert Rubin and most of his successors, have told us that a strong dollar is good for America.

Reality: Of all the myths that that have been perpetrated by those walking through the revolving door between Washington and Wall Street, this has probably been the most damaging. As Edward Alden recently stated:

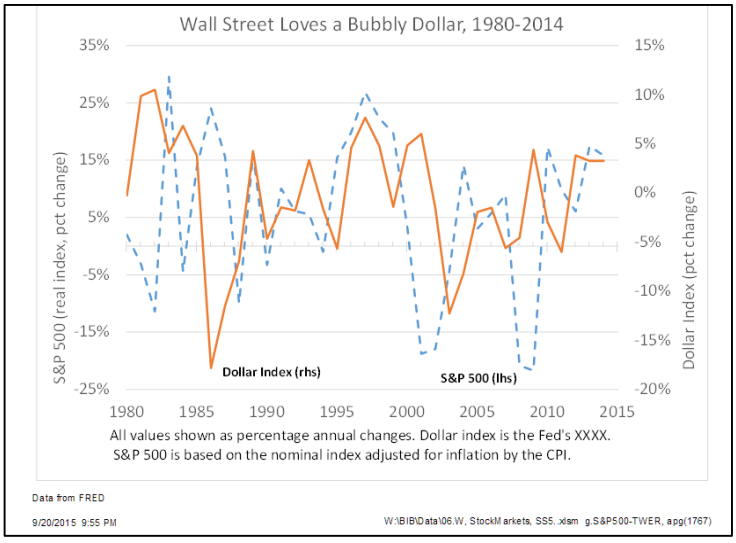
> "The worst thing to do is for the U.S. government to be actively encouraging currency movements that will undermine its own policy of rebuilding American manufacturing, increase protectionist sentiment in Congress, and make it far more difficult to move forward with the TPP and other trade negotiations. At the very least, it is past time for the government to stop talking about how a "strong dollar" is good for the United States." [41]

Although the strong dollar mantra might simply reflect misguided, misinformed national pride, it could be that self-interest is a significant factor. Changes in stock market valuation show a high degree of correlation with changes in the dollar's value (Figure 7). When the dollar bubbles, so does the market!

A corollary myth is often trotted out along with the strong dollar mantra: a strong dollar makes it possible for the average American to buy goods more cheaply -- but please don't mention that a strong dollar also makes foreign travel, foreign wines, and foreign sports cars more affordable – for those who can afford them.

In the real world, the benefits of a strong dollar in terms of lower prices for imported goods are generally exaggerated. Total imports represent only 16 percent of total U.S. GDP. If the dollar were to drop by 10 percent, this could ultimately raise average U.S. prices by 1.6 percent.[42] But at the same time, if moving to a more competitive dollar reduced the trade deficit from four percent of GDP to two percent and domestic production increased by two percent, leaving America with an unchanged supply of goods to consume, this would put nearly two million people back to work.[43]

Fig. 7. U.S. Dollar and U.S. Stock Market – Boom Together



For these people, working perhaps for the first time in years, the 1.6 percent increase in the cost of imported lunch

boxes at Wal-Mart means nothing to them compared to their being able to walk into the store with a paycheck in their pockets. Likewise, for those who already have jobs, a 1.6 percent total increase in prices over the course of two to three years would be far less than the *annual* inflation in America.

MAC: A strong dollar may be in the best interests of Wall Street, of members of Congress, and of government officials who would rather borrow to cover the budget deficit than to fix the budget deficit with higher tax receipts, lower expenditures, or both. But an overvalued dollar is clearly not in the best interests of American manufacturing or of the average American. Nor is it in the best interests of national security or future generations. An overvalued dollar does not make America strong; it makes America weak, both today and tomorrow.

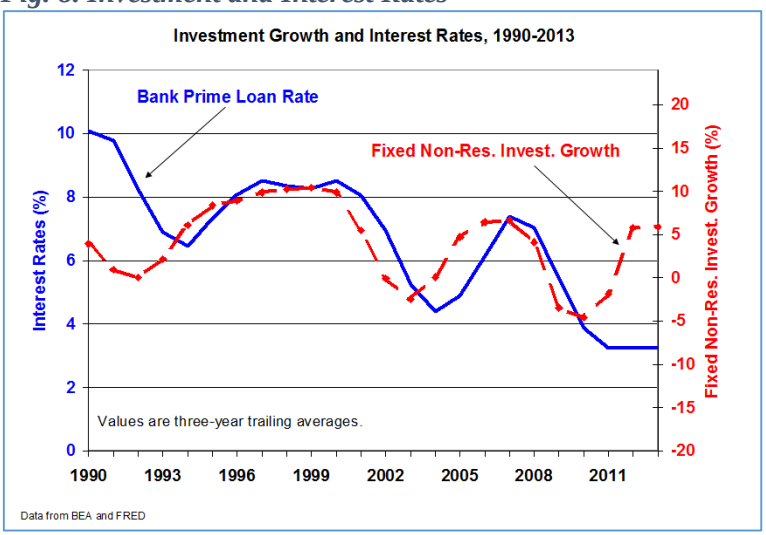
In contrast, a MAC would move the dollar to a competitive equilibrium level and keep it there. This would indeed make America strong again. America needs a sound dollar that benefits everyone, not an overvalued dollar that benefits the few at the expense of the many.

- **Investment, Growth and Interest Rates**

Myth: Low interest rates are needed to stimulate investment and growth. Higher interest rates will hurt jobs, especially in factories producing consumer durables, because purchases of such goods are commonly financed with interest-bearing loans rather than being paid in cash.

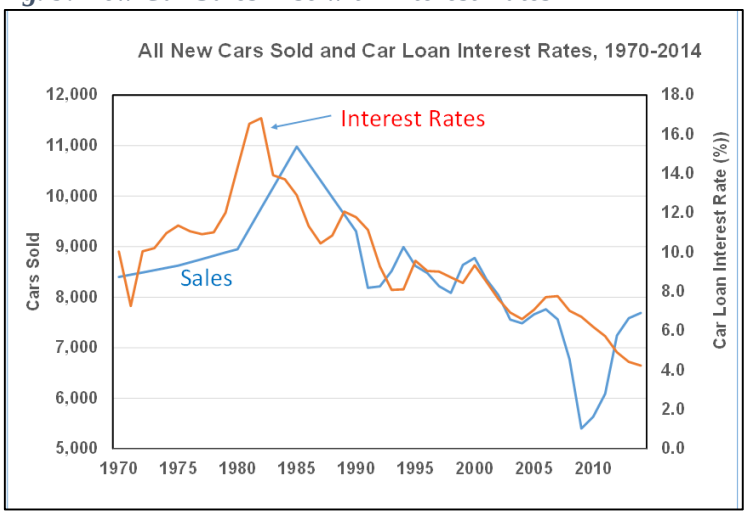
Reality: The low-interest-rates-mean-high-investment-myth is just that – a myth. Real investors invest to earn good money, not to spend cheap money. Too much cheap money means too many bad investments – ones that will not repay the money invested with interest. As shown in Figure 8, real non-financial investment in America goes up when interest rates go up – exactly the opposite of what the myth-spinners would like us to believe. Investment goes up not because money is cheap, but because the economy is growing, and a growing economy holds promise of growing profits. Increased demand for investments is what drives up the interest rates.

Fig. 8. Investment and Interest Rates



But will the higher interest rates stimulated by a MAC hurt sales of consumer durables like cars? No. Although it may seem counterintuitive, car sales and interest rates generally rise together as shown in Figure 9. For example, between 1971 and 1982, interest rates on car loans went up by 131 percent (from 7.3 to 16.8 percent) and the total sales of new cars grew by 16 percent.

Fig. 9. New Car Sales Rise with Interest Rates

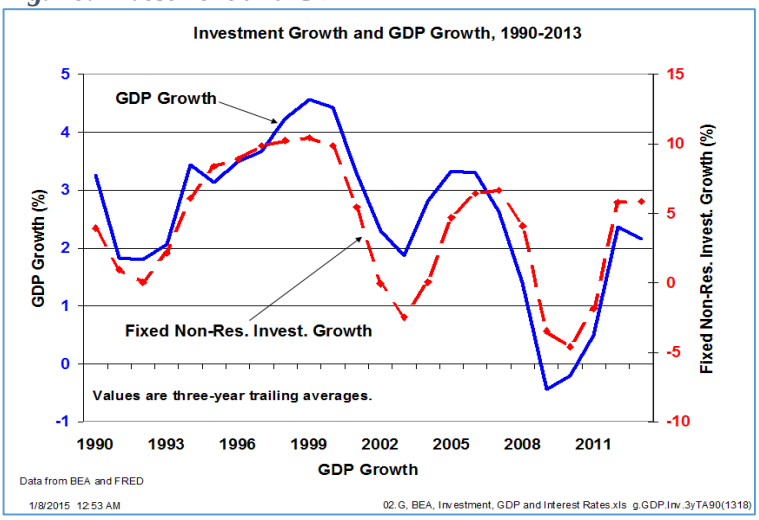


In contrast, between 1985 and 2010, interest rates went down by 52 percent (from 12.9 to 6.2 percent) and the number of new cars sold dropped by 49 percent. How can this be? Very simple. Interest rates tend to rise when the economy is booming and fall when the economy is slowing. People are far more likely to have good jobs and feel comfortable borrowing to buy a car when the economy is booming. Hence the positive correlation between interest rates and car sales.

A similar picture emerges when we look at investment and growth in the economy at large (see Figure 10).

MAC: Even though a MAC might cause interest rates to rise marginally, it would actually be a powerful stimulus for savings, investment, growth, and jobs in American manufacturing because it would dramatically increase prospects for making money.

Fig. 10. Investment and GDP



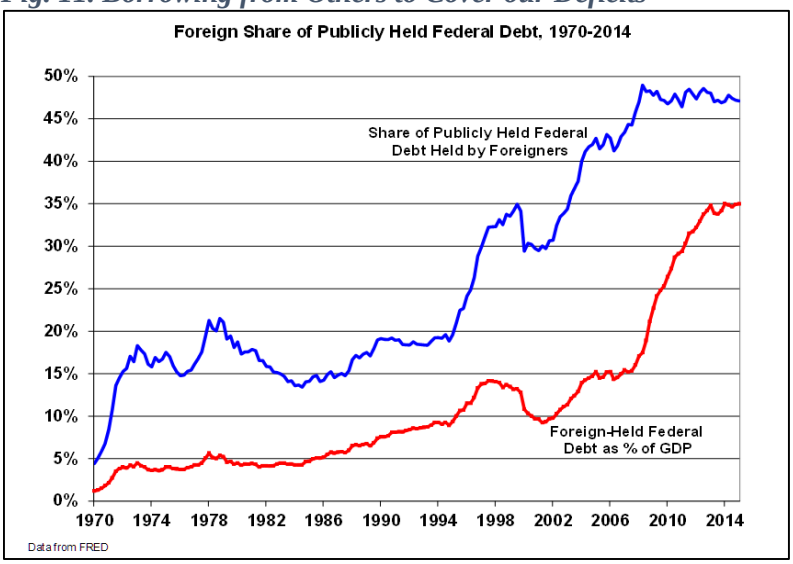
- **Interest Rates and the Cost of Government Borrowing**

Myth: Interest rates should be kept as low as possible to reduce the cost of servicing the public debt and to minimize the size of America's budget deficits.

Reality: If America's economic and financial strength is to be restored, providing a solid basis for a renaissance in manufacturing, our focus must shift from (a) minimizing the cost of servicing budget deficits to (b) maximizing the growth of the economy. One of the main reasons that America is in such a mess today is that the focus has been on (a) rather than (b).

Perhaps the most telling example of this is the dramatic shift since 1970 from Americans financing the government debt by buying bonds, a long-standing tradition that helped keep our country stay strong through two World Wars, to financing government debt by borrowing from foreigners. Between 1970 and 2014, the share of publicly-held federal government debt owned by foreign lenders rose from five percent to forty-five percent (Figure 11). On the surface this may look like a good deal – borrowing from abroad lowers the cost of servicing public debt because foreign investors are willing to accept lower interest rates in exchange for the security of America's financial markets and of U.S. treasuries.[44]

Fig. 11. Borrowing from Others to Cover our Deficits



However, this approach has probably increased rather than reduced the public deficit for the following reasons, all of which are tied directly or indirectly to the impact that such borrowing has had on GDP growth, government revenues, and government expenditures.

When the U.S. Government borrows from fellow Americans, it simply shifts purchasing power from the American people to the American Government. As Paul Krugman has said, it is simply debt that we owe ourselves. And since total purchasing power in America does not increase, the risk of additional inflation is nil. Some may argue that Government borrowing "crowds out" more productive private sector investment, but this argument fails on two counts.

First, since internal cash flow is sufficient to cover most investments of businesses outside the financial sector,[45] non-financial business investment is not particularly interest-rate sensitive and does not depend on being able to borrow from the financial markets.[46]

Second, to the extent that government expenditures might generate lower real returns than private expenditures, this would simply reduce standards of living rather than increasing domestic inflation and reducing international competitiveness.

However, when the Government borrows from abroad, this immediately increases the total amount of money (purchasing power) circulating in the economy and thus the risk of inflation. But this is not the end of the story. Because American banks (as in most countries) operate on a fractional reserve system, a million dollars borrowed from China, for example, could increase total domestic credit and purchasing power by nearly ten million dollars if banks were only required to keep 10 percent of deposits received in reserves, allowing them to relend the remaining 90 percent. Because foreign borrowing has essentially the same "high powered money" effect on total credit in the economy as money that is "printed" by the Government, the sharp increase in the share of borrowing from abroad to finance budget deficits has dramatically increased the total credit outstanding and thus the risk of domestic inflation, real exchange rate overvaluation, and trade deficits (see Figure 3 above).

MAC: By helping establish a truly competitive exchange rate that makes American manufacturing more competitive and more profitable, a MAC could make major contributions to balancing the Federal Government budget. Increasing economic growth would lead to higher tax revenues – even if tax rates were reduced in the context of much-needed reforms of the U.S. Tax Code. Also, higher profits and wages would make it possible to reduce government expenditures on relief programs. Furthermore, a MAC could generate hundreds of billions of dollars of additional revenues from foreigners seeking to exploit America's financial markets.[47]

Yes, faced with the above myths from the past, building consensus on a MAC to improve the international competitiveness of American manufacturing and to restore balance to America's external trade will take a lot of work. But the MAC proposal will generate some very important benefits for Americans across the political, economic and social spectrum, benefits that, with effort, can be fanned into a forceful tailwind that will help assure that America has policies appropriate to the 21st century.

Potential MAC Tailwinds

The biggest tailwind for introducing a MAC is that it would provide important benefits for all major stakeholder groups in the American economy – workers and their families, manufacturing and non-manufacturing businesses, government, and the financial sector. Introducing a MAC would also move us one step closer to realizing the American Dream – a country where we live in shared prosperity, at peace with each other and with the world at large.

- **Benefits to Workers and their Families**

By making made-in-America goods internationally competitive, both at home and abroad, a MAC would make American workers internationally competitive. With a trade-balancing exchange rate, Americans could go to work knowing that their jobs will still be there, that production has not been moved to a foreign land where wages are artificially low because of the overvalued dollar.

The International Trade Administration estimates indicate that one billion dollars of merchandise exports supports about six thousand jobs. Since implementing a MAC could increase net exports from a minus $500 billion or so today to zero, it could potentially put an additional three million people back to work. This would reduce the "headline" unemployment rate by over half -- from more than five percent at present to about two percent. Such a sharp reduction in the unemployment rate would increase family incomes for those currently without jobs, and by tightening labor markets, raise wages in general, benefitting all American workers and their families.[48] Higher wages and more available jobs would also bring the U.S. labor force participation rate back to more normal levels, again raising family incomes, especially among the lower income groups. And, as noted above, a MAC would have such a small impact on inflation that most of the increased wage income would represent a real increase in living standards.

Since we live in a democracy where every vote counts, if millions of Americans understood that their family incomes would rise if a MAC were introduced, this could provide a powerful tailwind for adoption of a MAC. However, the average American has had little reason or opportunity to study the connection between exchange rates, job availability and wages. Consequently, major efforts will be needed to help America understand why a fairly competitive dollar is so important. Hopefully, slogans during the presidential campaign such as "Make America Competitive Again" will be heard as much as slogans already in use such as "Make America Great Again." The latter cannot be achieved without the former.

- **Benefits to Businesses**

The businesses that would benefit most directly from a MAC would of course be those in the manufacturing sector, and mobilizing an understanding of a MACs potential among America's manufacturing leaders could provide a powerful tailwind for implementing a consensus policy for restoring the sector and improving the balance of trade.

Among manufacturers, those competing directly with products being imported into the United States today would be the most immediate beneficiaries of a MAC because a more competitive dollar would, in a sense, act like an across-the-board import duty, not one focused only on selected products from selected countries.

But MAC-based benefits would be far broader, also benefitting (a) manufacturers who are forced to keep prices artificially low to "meet the China price" to keep out *potential* foreign imports, (b) manufacturers who produce exportable goods, (c) all American businesses supplying inputs to manufacturing firms, and (d) all American businesses selling goods and services to those whose earnings depend on the competitiveness of American manufacturing. The only exception might appear to be businesses that consume imported goods. However, since these products represent only a small percentage of GDP, most of which are already invoiced in dollars, any negative impact would be muted and spread out over time. In sum, introducing a MAC would be a win all the way around for American businesses.

- **Benefits to Government**

Introducing a MAC would generate important benefits that should attract support from those who would like to see reduced Government budget deficits, and for those who would like to see Government provide better services to the American public, especially those most in need of the training and support required to be able to take full advantages of the benefits of globalization.

How can both of these goals possibly be realized with a single policy, you ask. The secret lies in the MAC's design.

- The MAC would lead to significantly higher GDP growth, providing more revenues even if some tax rates were reduced in the context of much needed tax reforms (see Table 1);

- The higher economic growth stimulated by a MAC would mean fewer business failures and fewer destitute households, thus reducing the need for business bailouts and family income support expenditures;
- Money not spent in emergency support for businesses and households could be spent improving schools, infrastructure, and the like, thereby increasing international competitiveness; and
- During periods of greatest need when trade deficits were sapping America's economic strength, the MAC would be generating large flows of non-tax revenues – *based on charges paid by foreign investors, not Americans*. (Table 2)

MAC's Indirect Revenue Enhancement through Economic Growth: The first, most predictable, and most important way in which implementing a MAC would increase government revenues and reduce the government deficits would be by stimulating economic growth. As is well known, external deficits are a serious drag on the economy.

Table 1. By Growing the Economy, the MAC Grows Revenues

MAC Impact on GDP Growth and thus on Revenues

Variables	Value	Unit
Growth Increment = Reduction in Current A/C Deficit		
Base-Year Data		
GDP	17,968	$ bls
Total Federal Revenues	3,200	$ bls per year
Percent of GDP	17.8%	

Growth Increment = Reduction in Current A/C Deficit (% of GDP)		
	Deficit	Reduction = Added Growth
Current Deficit	2.6%	--
Trigger Deficit	1%	1.6%
True Balance	0%	2.6%

Annual MAC Impact on Federal Government Revenues at Current Tax Rates			
	Rev ($ bls)	% of Cur. Rev	% of GDP
Trigger Deficit Reached	50	1.6%	0.3%
True Balance Reached	82	2.6%	0.5%

Note: This model estimates the revenues that a Market Access Charge (MAC) will generate, not in terms of MAC revenues collected directly on capital inflows, but in terms of revenues generated by existing taxes on the additional GDP that the MAC would stimulate by eliminating most or all of today's current account deficit.
The additional revenues gained will be net gains since the Government will not need to spend money to earn this additional revenue. In fact, the additional revenues earned on additional GDP will be in addition to those earned directly from collection of the MAC charge.
Provided normal government expenditures are not increased as a share of GDP, the direct and indirect revenue increases generated by the MAC will translate directly into deficit reductions.
By reducing the need to borrow at interest, there savings will generate furtjher reductions in the Federal Government Deficit, triggering a virtuous cycle of fiscal strength and stability.

As seen in Table 1, current account deficits are now chopping 2.5 - 3.0 percent off the U.S. growth rate. Implementing the MAC would reduce the current account deficit, which would increase economic growth in like amount. In turn, the added economic growth would increase revenues by at least 1.6% *at current tax rates*. Assuming the current ratio of revenues to GDP is maintained, this would increase revenues by the same percentage. With the current budget deficit estimated at 2.4% of GDP, adding these revenues, which are equal to 0.3%-0.5% of GDP, could bring the deficit down to 2% of GDP or less, levels achieved only 16 times in the past 45 years!

MAC's Direct Revenue Enhancement. The MAC would also reduce the budget deficits in a very direct manner. Funds from the MAC assessment on foreign investors seeking to exploit U.S. financial markets would flow directly into the U.S. Treasury.

Estimating the impact of revenues based on the MAC charge is far more difficult than estimating those based on GDP growth because the MAC is a major new policy tool that has never been used. The main unknowns are the following:

a) the initial rate at which the MAC is introduced;[49]

b) the pace at which excess capital inflows decline as a result of the MAC charge;

c) the pace at which the exchange rate changes as capital inflows reach more reasonable levels, and

d) the speed with which the trade deficit moves below one percent of GDP as the exchange rate changes.

Estimating these values quickly takes us into the realm of the unknown because, although countries like Brazil have had policies vaguely similar to the MAC, the differences between the Brazilian "tax on financial operations" (IOF) and the MAC, for example, are very large, as are the differences between the Brazilian and American economies. The same is true for other mechanisms tried in other countries.

Despite these uncertainties, it is nevertheless useful at least to define the approximate boundaries of the ballpark we are talking about. Table 2 tries to do so with a High Case and a Low Case.

High Case: The High Case assumes that the current cross-border flows of capital into the United States remain at the levels reported by the Bank for International Settlements in its triennial report on such flows (BIS, 2013).[50] Implicitly, this assumes that foreign investors regard the MAC charge as so trivially small that they do not reduce the volume of capital they bring into the United States – which is currently over $200 trillion dollars per year! With inflows at that level, it is not surprising that even a 50

basis point charge would generate an impressive flow of revenue –over one trillion dollars per year, which is equal to one third of total U.S. Government revenues from tax and non-tax sources in 2015!

Table 2. Estimates of MAC Revenue Collections

Indicative Range of Potential Revenue Yield from a MAC ($ bls per year)

Key Variables (2015)	Low Case	High Case
Current Account Deficit ($ bls/yr)	461	--
Ratio of Gross Capital Inflows to Current Account Deficit	3.6	--
Gross Capital Inflows ($ bls/yr)	1,658	*211,013*
Low Case: Current Account Deficit Anchor ($ bls/yr)	*1,658*	--
High Case: BLS Cross-Border Capital Flows Anchor ($ bls/yr)	--	*211,013*
MAC Rate (basis points)	50	50
MAC Revenues ($ bls/yr)	8.3	1,055
Federal Government Revenues ($ bls/yr)	3,200	3,200
MAC Revenues / Federal Revenues	**0.26%**	**33.0%**

Sources: Data from BEA, BIS, IMF, FRED, and author's calculations.

Notes:

Low Case assumes MAC halts all speculative flows and is driven only by the gross inflows of capital coming in to cover the current account deficit and normal capital outflows.

High Case assumes that the MAC has no impact on total capital inflows to the United States as reported by the Bank for International Settlements in its Triennial Survey of 2013, with adjustments to bring totals forward to 2015 base year.

However, it is highly unlikely that such levels of revenue could ever be generated by the MAC. Since foreign speculators get into U.S. forex markets for margins of a few "pips" (which are about the same as basis points), a MAC charge of 50 basis points would make a substantial share of these casino-style trades unprofitable and the inflow would diminish. This would allow the dollar to return to more competitive levels – which is precisely the purpose of the MAC.

The high case is nevertheless instructive because it reveals the massive size of the foreign capital flows moving in and out of the United States. This size lends great credibility to the hypothesis that such capital flows, not flows of real goods and services that are forty times smaller, are the primary determinant of the dollar's seriously misaligned exchange rate.

Conversely, the Low Case almost certainly understates the revenues that could be generated by the MAC. The Low Case assumes that all foreign investors are so rate-sensitive that even a 50 basis point charge will discourage them from bringing in money. The Low Case further assumes that the only incoming flows would be the gross annual capital flows driven by America's need for funds to cover the current account deficit and to cover the repayment of loans and other net outflows on the capital and financial accounts of the balance of payments.

This scenario, which would involve gross capital inflows equal to only eight-tenths of one percent of the flows in the high case, is plausible but highly unlikely for two reasons. First, serious investors, especially those engaged in foreign direct investment, bring capital into the United States expecting returns far higher than the MAC's 50 bp charge. To them, the initial MAC charge, which is less than the daily average fluctuation of the dollar against the euro, would be completely irrelevant to their investment decision making process. Second, as Rob Scott (2016) and others have pointed out, governments that are actively manipulating their currencies are not particularly yield-sensitive. They will even take losses on currency transactions in order to establish a more competitive rate for their own exporters.

In sum, we can dismiss both the High Case, where a MAC would generate revenues equal to one third of total Government revenues, and the Low Case where a MAC would generate revenues equal to less than one third of one percent of total Government revenues. Nevertheless, the model is useful in that it sets some broad parameters within which additional revenues from the MAC charges and from the growth stimulated by the MAC are likely to fall.

Government's Benefit-Cost Balance. Perhaps the most important conclusions that we can draw from this analysis is that, from a cost-benefit perspective, the Government is likely to do very well – even if the MAC increases interest rates slightly by moderating the incoming flow of foreign capital.

Because of the global glut of savings, which is reflected in historically low interest rates, the U.S. Government is in a buyer's market when it seeks to fund its deficits. It is therefore reasonable to assume that investors lending to the U.S. Government will only be able to increase the effective interest rates on government bonds by the amount of the MAC, leaving the net return received unaffected since the 50 bp MAC charge would be offset by a 50 bp increase in the average interest rate on U.S. treasuries. And here's the good news. This would also leave the U.S. government unaffected because any increase in rates on government borrowing because of the MAC would be offset by the MAC charges received.

But here is where it gets really interesting. Between 2010 and 2015, gross government debt outstanding increased by an average of $1.1 trillion per year. Even if 100 percent of this increase were to be financed by borrowing from abroad, the foreign exchange that currently comes into the United States in about one day out of the 252 trading days per year would be sufficient to finance the entire average increase in Federal debt for a year!

The above leads to three welcome conclusions. First, since the MAC revenues would offset more or less exactly the increased interest rates demanded by lenders, the government would break even in terms of interest costs on incremental borrowing. Second, the same would apply to the roll-over of existing debt. Lenders might demand a yield increase equal to the MAC charge, but the cost to the government of this would be offset by the Government's receipt of the MAC charge. Third, since the MAC would be collected on all capital inflows, the MAC revenues from 251 of the 252 trading days per year would be a net gain. And this does not even consider the additional revenues that the Government would realize because the MAC would grow the economy and thus the tax base as noted in Table 1.

- **Benefits to the Financial Sector**

Although some may think that a MAC might harm the financial sector, introducing a MAC would actually benefit the sector in important ways.

(a) *Higher returns with lower risks*. The petrodollar recycling fueled by the OPEC oil crisis in the early 1970s, plus global financial booms in the 1980s and 1990s, flooded America's financial markets with so much capital that financial firms found it hard to meet investors' demands for securities with high returns and low risks.[51] The consequent "search for yield" induced the creation of artificial investment vehicles, most of which juiced up returns with devices such as debt leveraging, securitization to hide the low quality of underlying assets, and other tricks ranging from financial engineering to financial fraud. All of this created the catastrophic risks that led to the Crash of 2008. By reducing the glut of hot money in the U.S. financial markets, a MAC would make it easier for the sector to meet the demand for higher yields and lower risks.

(b) *Financial stability:* Introducing a MAC would significantly reduce the risk of future capital-driven boom-bust cycles that would again wreak havoc on America and on the world. With the supply of incoming foreign capital more closely matched to America's need for such capital, the manic search for yield would die down, returning America's financial sector to its real reason for being – to intermediate between savers and investors at the lowest possible cost. This would stimulate savings by maximizing returns to savers, and stimulate investments by minimizing costs to investors.

With a MAC in place, the financial sector would be driven less by traders' testosterone and more by investors' insights. Those longing for the excitement of gambling with other people's money could go to Las Vegas and set up a betting shop.

- **Benefits to U.S. Monetary Policy**

The Federal Reserve has long used the Federal Funds rate to keep the money supply consistent with America's need for credit. This worked moderately well when the Federal Reserve's actions were the main determinants of the domestic money supply. Since the 1970s, however, foreign capital inflows have added significantly to the total stock of credit available in the United States. But at the same time, America's monetary authorities have not had a tool comparable to the Fed Funds rate designed to keep the inflow of foreign money consistent with America's needs. The absence of this important tool has made domestic inflation worse, and has led to the dollar's overvaluation, domestic asset bubbles, and financial crises.

A MAC would provide this badly needed monetary policy tool, thereby helping to assure America's economic and financial stability in the highly financialized world of the 21st century.

- **Benefits to National Security**

America's national security has been put at risk by our increasing reliance on foreign suppliers, especially "frenemies" like China. Some products critical to our national security in times of peace and war are no longer produced in America, or are produced on such a limited scale that a breakdown of trade during a global crisis would leave America without adequate supplies.[52] A MAC would significantly increase America's national security by restoring the international competitiveness of American manufacturing and thus the market incentives to restore and maintain America's capacity to produce goods critical to its national security.

- **Benefits to Trade Agreements**

Free trade agreements (FTAs) such as the Trans-Pacific Partnership (TPP) are urgently needed to increase the access of U.S. exports to foreign markets, to reduce thefts of intellectual property, to assure that state-owned enterprises behave like private firms, and to reduce the fear of many Americans that FTAs will generate a "giant sucking sound" that takes jobs and factories from America to foreign lands. By sharply reducing such risks, a MAC would make it far easier for the United States to participate in FTAs.

MAC - The Silver Bullet that Will Cure All Problems Tomorrow?

If America were to implement a full-blown MAC today, would this make U.S. manufacturing fully competitive tomorrow, close the U.S. trade deficit, and assure prosperity for all Americans now and forever more? No. Definitely not. A MAC will probably have to be in place for two to four years before

its impact on exchange rates has developed fully and resulted in balanced trade. At the same time, supporting investments in plant, equipment, R&D, skills training and the like will be needed.

However, as important as these complementary investments are, putting a MAC into place needs to be the number one priority. By moving the dollar to a fair, internationally competitive value, the MAC will make it possible for American manufacturing to compete profitably with imports in the domestic market and with global producers in export markets. These profits will in turn provide the urgently needed incentives and financial means that will be required to carry out the investments required to increase productivity, wages and living standards.

C. Conclusions

America's rising trade deficits and debts have been driven in large measure by declines in the international competitiveness of its manufacturing sector. The primal driving force behind both trade deficits and reduced manufacturing competitiveness has been the dollar's overvaluation. This overvaluation reflects excessive foreign demand for dollars and dollar-based assets. Due to the dramatic increase in international capital flows since the mid-1970s, it is trade in these financial assets, not trade in real imports and exports, that now sets the dollar's exchange rate. Consequently, the dollar's exchange rate rarely balances U.S. imports and exports today.

After reviewing the probable effectiveness of virtually all proposals currently under discussion to reduce America's trade deficits and to increase the competitiveness of American manufacturing, this paper concludes that, without question, America needs to introduce a policy like the Market Access Charge (MAC), one that works not on symptoms of an overvalued dollar such as excessive imports, but one that actually fixes the underlying cause of the overvalued dollar – the excessive foreign demand for dollars and dollar-based assets in America's financial markets in a world where exchange rates are driven more by trade in capital assets rather than by trade in real goods and services.

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Annex A. Glossary of Basic Terms

This glossary provides *basic* definitions of some of the economic terms and jargon used in this note. I've tried to keep such words to a minimum in the text, but using them often avoids using much longer descriptions that quickly become clumsy. Also, some of the terms used here are defined differently in different contexts by different authors, so it is good to have a common reference point.

Currency Manipulation: Currency manipulation involves the purchase and sale of domestic and foreign currencies in international currency markets with the intent of forcing the domestic currency down, making domestic goods more competitive in domestic markets with imports and more competitive in global markets as exports.

> *Though seemingly straightforward, this common definition is fraught with important ambiguities that make it easy for countries to manipulate their currencies without technically being currency manipulators. The biggest loophole is the fact that, without buying and selling foreign exchange, a country can gain competitive advantage by implementing a wide range of other policies such as the QE programs of the Federal Reserve and the Bank of Japan, which have involved "printing" massive amounts of domestic currency. Though these governments commonly claim that their* ***intent*** *is only to provide a "domestic economic stimulus," the end result in terms of impact on the international competitiveness of these countries is essentially the same as what they could have attained had they actively purchased foreign exchange with the sale of domestic assets such as currency and government securities.*
>
> *Another loophole is the fact that countries can very legitimately use domestic currency to purchase foreign currencies and other assets. For example, national pension and sovereign wealth funds commonly do this to diversify holdings, increase yield, and reduce risk. Such transactions may well affect exchange rates and thus international competitiveness, but proving that this, not risk diversification, was the* ***intent*** *of such purchases is virtually impossible.*
>
> *Countries like China that have a "state capitalism" system can acquire massive amounts of foreign exchange without even purchasing it with domestic currency. The state is the sole or dominant owner of many companies that may earn large amounts of foreign exchange through exports. All the state has to do to increase its foreign exchange reserves is to take part of all of this foreign exchange as distributed profits. And without entering foreign exchange markets like those found in true market economies, the state, through the state bank, can simply have the state-owned exporter deposit its foreign exchange earnings in accounts denominated in domestic currency, retain the forex, and attain the same result.*
>
> *The other very big problem with defining "currency manipulation" and sanctioning a country for it is that exchange rates can get out of line with the rates that would balance imports and exports – the equilibrium exchange rates – for reasons totally separate from any government policies.* ***In fact, the failure to prevent exchange misalignments caused by natural market forces has been one of the biggest failures of America's international monetary policy for decades.***
>
> *Specifically, as issuer of the world's dominant reserve currency and home to the world's best financial markets, hundreds of billions of dollars' worth of foreign capital have come into America, a process greatly accelerated by the rapid financialization of the world economy. In the absence of any mechanism designed to keep this flow consistent with America's real need to import capital from abroad, these flows have pushed up the dollar's exchange rate to levels so high that America cannot compete internationally on a level playing field. Hence America has suffered massive trade deficits, lost jobs, off-shored factories, and debts to foreigners. These flows had nothing to do with currency manipulation. They were simply a totally normal reaction of the global financial market to the opportunities to invest in U.S. markets with attractive yields and low risk.*

America has been far too ready to blame China for its trade deficits. China actually accounts for less than 20% of America's total imports. We need to recognize that forces totally out of China's control have also affected the dollar's exchange rate, not just with China, but with the world at large. We need to take steps to bring our own currency back to levels where Americans can earn as much producing exports as they spend on imports.

Cross-border capital flows: Capital that moves from one country to another in any form. It could be physical such as monetary gold or currencies, but far more often capital moves as accounting entries. The accounting entries can reflect financial capital in any form – from highly liquid cash balances to debt instruments of various types such as bonds, to ownership rights in physical farms, factories, real estate and the like. Explicitly excluded are transfers of services, including financial services such as banking fees, and goods, which are considered imports and exports. Such transactions appear, not on the "financial account" of the balance of external payments, but on the "current account" where transactions in goods and services are recorded. Capital inflows and capital outflows differ only in direction of the flow.

Equilibrium exchange rate—The exchange rate that balances imports and exports on the current account – the exchange rate that allows Americans to earn as much producing exports as they spend on imports.

Overvalued dollar: The dollar is considered to be overvalued if, under current circumstances, imports exceed exports and America has a trade deficit.

An exchange rate for the dollar always exists that can balance imports and exports, assuring that Americans can earn as much producing exports as they spend on imports. At present, the exchange rate is seriously overvalued – probably by about 30 percent. This makes foreign goods from China and elsewhere such as clothing and steel excessively cheap, and exports from the U.S. such as cars and airplanes excessively expensive. As a result, Americans who are seeking to get the most for their money, end up buying more from abroad than they sell abroad. This difference shows up as a trade deficit, and to finance the trade deficits, America ends up borrowing from countries like China – in order to pay them to produce for us what we could produce for ourselves if the dollar were not overvalued. And because we have been running trade deficits for most of the past 40 years, we keep piling up unpaid bills to foreigners. As a result, every man, woman, and child in America now owes about $23,000 to foreigners – on top of all the credit card debt, car loans, and mortgages that we normally think about.

Quantitative easing (QE): When the Federal Reserve (the "Fed") seeks to stimulate economic growth by "printing" money and injecting it into the economy by purchasing bonds and other securities held by the public.

Trade balance (deficit or surplus): The value of goods and services sold to other countries minus the value of goods and services purchased from other countries. In brief, exports minus imports.

Annex B. The MAC's Automatic Rate Adjustment Mechanism

This annex provides a brief explanation of the way in which the MAC rate would adjust automatically according to the prevailing level of the current account deficit relative to GDP at the time of each semi-annual review.

In summary, the MAC rate is zero until the current account reaches the trigger level, defined as a share of GDP. At this point, the initial non-zero MAC rate goes into effect to start moderating foreign capital inflows that are driving the dollar to non-competitive levels. If the current account deficit continues to rise, the MAC rate will be raised accordingly. Once the current account deficit begins to decline, the MAC rate automatically begins to decline until, at the trigger level, it goes to zero.

The process as laid out in the table below allows automatic calculation of the MAC charge at any current account deficit level once the trigger level is reached.[1]

MAC Adjustment to Current Account Deficit

Variable	Value	Unit
A. Trigger Level (% of GDP)	1.0%	% of GDP
B. Initial MAC Rate	0.5	percent
C. (in basis points=)	50	bp
D. Current Account Level	**3.0%**	% of GDP
E. Excess over Trigger	2.00	points
F. Elasticity	0.5	elast.
G. Rate increase over MAC base rate of 50 bp	1.00	
H. **MAC Rate(** for present current account deficit)	**1.5**	percent

Explanation

A. The C/A deficit at which the MAC moves to a non-zero rate.
B. The initial non-zero MAC rate applied when trigger point (A) reached.
C. Initial MAC rate in basis points instead of as percentage.
D. **Present current account deficit as % of GDP.**
E. Difference between current level (D) and trigger level (A).
F. The ratio of the excess of deficit over trigger to change in % MAC rate.
G. Increase in MAC charge = Base Rate (C) + (Excess over Trigger Level (E) times Elasticity (F)).
H. Resulting MAC rate at the current current account deficit level as % GDP.

[1] The underlying Excel table is available directly from the author (see contact links on cover page), and will soon be available under "Resources" on his blogsite Americans Backing a Competitive Dollar.]

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End Notes

[1] Data on the share of exports in GDP is drawn from the Bureau of Economic Analysis (BEA) database. Data on high tech exports is from the World Development Indicators maintained by the World Bank.

[2] Measured in terms of net international investment position data from the IMF. In fact, the U.S. is by far the largest net international debtor, accounting for 36 percent of all net global debt in 2013 and, on the basis of IMF data available at time of writing, to 49 percent of the global total in 2014. In fact, America's NIIP fell from a negative $5.5 billion in 2013 to a negative $7.0 billion in 2014, an increase about 40 percent larger than the *total* net debt of Spain, the world's second largest net debtor.

[3]Warren E Buffett and Carol J. Loomis (2003). "America's Growing Trade Deficit Is Selling the Nation Out from Under Us. Here's a Way to Fix the Problem--and We Need to Do It Now," *Fortune*, Nov. 10,.2003 [http://www.berkshirehathaway.com/letters/growing.pdf].

[4] Based on data from TradeStats Express at the U.S. International Trade Administration.

[5] Data from the Bureau of Economic Analysis, International Transactions.

[6] Consider, for example, India's major exports to the United States of computer programing, call center assistance, interpretation of MRIs and other medical tests, and preparation of tax documents.

[7] Estimate based on U.S.-ITA calculations that a billion dollars of net exports supports nearly six thousand jobs. See Martin Johnson and Chris Rasmussen, 2014.02.24, Jobs Supported by Exports 2013: An Update, Washington, D.C.: International Trade Administration.

[8] U.S. International Trade Administration.

[9] According to data from the International Trade Administration, only about two percent of U.S. imports are covered by antidumping and countervailing duties.

[10] Ian Talley, 2015.05.17, "How Much Should a Currency Be Worth? No One Really Knows – as debate over Pacific trade deal intensifies, U.S. lawmakers find themselves entangled in calculus that even IMF and WTO haven't been able to pin down," *Wall Street Journal*.

[11] Economist, 2015.01.18, Why the Swiss unpegged the franc.

[12] Currency manipulation generally focuses more on changing relative currency values to gain a competitive advantage for its domestic producers in international trade than on the money made by investing yuan in U.S. treasuries, for example. But even here, currency manipulators may well examine the costs as well as the benefits of manipulation.

[13] Baker Botts LLP, 2014 ca, A Guide to Demystify the CFIUS Process (Committee on Foreign Investment in the U.S.).

[14] See Nicolas Magud and Carmen M. Reinhart. 2006.01. "Capital Controls and Capital Flows in Emerging Economies: Policies, Practices and Consequences," (NBER Working Paper No. 11973) for a global summary of related initiatives. The current design of the MAC presented here is based in part on the lessons learned from the experience of other countries as summarized in this and related studies.

[15] Fred Bergsten and Joseph E. Gagnon (2012.12), *Currency Manipulation, the US Economy, and the Global Economic Order*, Policy Brief Number PB12-25. Washington, DC: Peterson Institute. **[**http://www.piie.com/publications/pb/pb12-25.pdf**]**

[16] Under realistic assumptions, the total cost of the MAC can be shown to a bit over one tenth of one percent of the total returns on a "normal" foreign direct investment project – hardly a show-stopper! For details see John Hansen, 2015.09.21, Why a MAC charge on DFI will Stimulate DFI [http://abcdnow.blogspot.com/2015/09/why-mac-charge-on-dfi-will-stimulate.html].

[17] Bank for International Settlements (BIS), 2014.02, Triennial Central Bank Survey of Global Foreign Exchange Market Turnover in 2013; Basel: BIS.

[18] Unlike the race-to-the-bottom, tit-for-tat countervailing currency manipulation that some have proposed, using MAC revenues to buy back U.S. securities from foreign countries has a self-limiting exit strategy. The MAC will reduce the dollar's overvaluation and, as this takes place, the revenues available to buy back more U.S. public debt held abroad will shrink, bringing this form of countervailing currency manipulation to a natural close at the point when the U.S. dollar is once again reasonably close to its fair value.

[19] Lawrence H. Summers and Ed Balls, 2015.01.15, *Report of the Commission on Inclusive Prosperity*, Washington: Center for American Progress.
[20] IMF (2012), *The Liberalization and Management of Capital Flows: An Institutional View*. Washington, D.C.: International Monetary Fund.
[21] OECD, 2015.4.17, OECD Approach to Capital Flow Management Measures Used with a Macro-Prudential Intent.
[22] Omnibus Trade and Competitiveness Act of 1988.
[23] The latest version of the *Semiannual Report on International Economic and Exchange Rate Policies* can be found here.
[24] Some free trade area (FTA) agreements signed in recent years by the U.S., such as the FTA with Peru, have investment chapters that support the free international movement of capital, but such agreements also provide Exceptions that allow countries to "safe-guard" their economies from excessive capital flows should the need arise. Similar safe-guard language appears in the TPP. Conclusion: the MAC would be consistent with existing U.S. laws including treaties.
[25] An increase of 10 percent in the final selling price, for example, would increase the profit margin by far more if the current profit margin were less than 10 percent. In sharp contrast, other options would do virtually nothing to stimulate U.S. production of manufactured exports and would only stimulate U.S. production of a very small share of U.S. imports.
[26] Congress, 1988, Omnibus Trade and Competitiveness Act of 1988.
[27] Semiannual Report on International Economic and Exchange Rate Policies.
[28] For economic analysis, international trade is recorded in a balance of payments account. The BOP is divided into current account transactions in real goods and services, and capital/financial account transactions in capital and other financial assets. By definition, the net capital/financial account transactions balance plus the nation's change in foreign exchange reserves must be equal to the net current account transactions balance.
[29] IMF, 2012, "Institutional View," op. cit.
[30] Jean-Louis Arcand, Enrico Berkes and Ugo Panizza (2012), *Too Much Finance?* IMF Working Paper WP/12/161. Washington: IMF. Their paper, "examines whether there is a threshold above which financial development no longer has a positive effect on economic growth. We use different empirical approaches to show that there can indeed be 'too much' finance. In particular, our results suggest that finance starts having a negative effect on output growth when credit to the private sector reaches 100 percent of GDP."
[31] Data based on gross domestic income per person measured in purchasing power parity terms at international dollars from World Bank, World Development Indicators database. [http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators].
[32] Patrick A. Mulloy, 2015.02.26, "Across the Pond: U.S. Opportunities and Challenges in the Asia Pacific," Testimony before the House Committee on Foreign Affairs Subcommittee on Asia and the Pacific Hearing.
[33] World Bank, World Integrated Trade System, acc. August 2015.
[34] Dobbs and Skilling, 2009.12.17, McKinsey, *Not-So-Exorbitant Privilege* .
[35] World Economic Forum, 2012, *Euro, Dollar, Yuan Uncertainties: Scenarios on the Future of the International Monetary System*. Geneva: WEF
[36] A multicurrency reserve system would also help eliminate the classic "Triffin Paradox" which holds that, on the one hand, the reserve currency country must run trade deficits that are covered by issuing more of the reserve currency so that other countries can obtain the reserves they need, but that, on the other hand, becoming a major debtor country with loose monetary policies and trade deficits sufficient to supply the world with adequate reserves will inevitably undermine the country's stability and reputation, thereby destroying the desirability of its money as a reserve currency.
[37] Daniel Griswold (2011.06.15), "Truth about Trade Deficits and Jobs," *Washington Times*. [http://www.cato.org/pub_display.php?pub_id=13197].
[38] Relevant indicators are available in the IMF's publication *International Financial Statistics.*
[39] Tyler Durden, 2014.04.03, The Chinese Are Buying Large Chunks of Land across America.
[40] Nathan Halverson, 2015.01.24, How China Purchased a Prime Cut of America's Pork Industry, Reveal News.
[41] Edward Alden, 2015.01.28, *The "Strong Dollar" Policy: Back to the Future.*
[42] This is a rough estimate that probably overstates the impact of a ten percent devaluation on the price of imports in the United States. Studies of exchange rate "pass-through" indicate that only part of the percentage change in the exchange rate is passed through to U.S. consumers for imported products, and the pass-through usually happens gradually over two to three years. Also, about 95 percent of U.S. imports are priced in dollars, and since foreign exporters generally want to maintain their market position in America, they may cut prices to maintain market share. For further details, see Owen Humpage, March 24, 2015, Exchange-Rate Pass-Through and US Prices, and Linda Goldberg and Cédric Tille, August 2006, "The Internationalization of the Dollar and Trade Balance Adjustment." New York City: New York Federal Reserve, Staff Reports (Number 255). [http://www.newyorkfed.org/research/staff_reports/sr255.html].
[43] Calculated based on data from BEA and, for export-related jobs, on U.S.ITA data in Jobs Supported by Exports 2014: An Update, March 2015.

[44] Francis E. Warnock and Veronica C. Warnock. 2006.10. *International Capital Flows and U.S. Interest Rates*, NBER Working Paper 12560, [Http://Www.Nber.Org/Papers/W12560]

[45] See, for example, J.W. Mason. 2015.02.25., Disgorge the Cash: The Disconnect Between Corporate Borrowing and Investment. New York: Roosevelt Institute. He notes, "In the 1960s and 1970s, an additional dollar of earnings or borrowing was associated with about a 40-cent increase in investment. Since the 1980s, less than 10 cents of each borrowed dollar is invested."

[46] Businesses of course do borrow, but such borrowing can be linked more closely to "financial engineering" – leveraging up with debt to finance share buybacks and dividend payouts, for example, than to real investment in plant and equipment.

[47] For a first cut at estimating potential revenues from a MAC charge on foreign investors, see Annex A.

[48] The data used in this paragraph are available on the BEA and FRED websites.

[49] Some have argued that, since the current account deficit is much closer to 3% of GDP than to the 1% of GDP trigger level where the MAC would go to a non-zero rate under normal conditions, the initial MAC rate should be set to the level that would normally be reached in stages under normal conditions. For example, if it is decided that the MAC rate should increase by half the percentage increase in the current account deficit once the deficit exceeds one percent of GDP, the rate would normally have climbed to 1.5% (150 bp) once the current account deficit reached 3% of GDP. However, given that the MAC may have a fairly substantial impact on international capital flows, it seems prudent to begin lower than this level and gradually move up to it. For a table showing how the MAC adjusts automatically to the severity of the current account deficit, see Annex B.

[50] Minor adjustments have been made to bring the data forward to the 20915 base year used here.

[51] For an interesting discussion by Stephen Gandel of the work of Ricardo Caballero on this issue, see Did Foreigners Cause America's Financial Crisis? *Time*, Jan. 15, 2010.

[52] See, for example, Defense Science Board Task Force, 2005.02, *High Performance Microchip Supply*. Washington: DOD