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The political economy of "currency manipulation" bashing☆

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ABSTRACT

In recent years, one of the most frequently debated issues in Congress has been the value of the Chinese renminbi (RMB) relative to the U.S. dollar. Many members of Congress often accuse China of being a "currency manipulator." This paper has two objectives. First, it investigates the extent to which PAC contributions from key interest groups as well as constituent interests influence the frequency with which members of Congress criticize China's exchange rate policy, controlling for other factors. The results indicate that the odds that a congressman will call China a "currency manipulator" are 1.35 times higher for every $5000 in PAC contributions from groups that favor legislation against China. In addition, the results show that a one percentage point increase in the share of the congressional district labor force in manufacturing is associated with a 19.6% increase in the likelihood that the district's legislator will label China a "currency manipulator." Second, this paper investigates the consequences that "currency manipulation" bashing may have on the rate at which the RMB appreciates against the U.S. dollar. The results for a VAR model indicate that an increase in the incidence of "currency manipulation" bashing appears to temporarily slow down, rather than accelerate, the rate at which the renminbi appreciates against the dollar. This result suggests that bashing China may actually be counterproductive.

1. Introduction

The value of the renminbi (RMB) relative to the U.S. dollar and how it influences the US–China trade balance has been one of the most salient and debated issues in U.S. Congress and the administration over the last few years. Many members of Congress lay blame on China's exchange rate policy for explaining the decline in U.S. competitiveness as well as the loss of "American jobs" to places overseas, and in particular, to China. Since 2003, this dispute has resulted in a rise congressional activity manifested in the introduction of several bills presumably aiming at rectifying the apparent inequities caused by China's currency policy stance (Xie, 2010). On September 29, 2010, the House of Representatives passed by a wide margin the "Currency Reform for Fair Trade Act" (H.R. 2378), a bill that would permit the imposition of countervailing duties on countries found to have an "undervalued currency."

Concurrent with the rise in China-related congressional legislation there has been a significant increase in verbal criticisms of China's exchange rate policy. When expressing these criticisms, legislators typically voice the particular grievance keywords "currency manipulation." For example, in March 2010, 130 congressmen signed a petition to Timothy Geithner, Secretary of the Treasury, urging him to officially classify China as a "currency manipulator." Such classification would then permit Congress to consider adopting punitive action against China (Staiger & Sykes, 2010).

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This paper is not about questioning whether the RMB is or is not undervalued relative to the dollar. A plethora of papers have already been written on this issue.[1] But China is not the only country in the world that may have had an undervalued currency. If fact, using IMF figures for the implied Purchasing Power Parity and actual exchange rates for 2009, the degree of the RMB undervaluation relative to the U.S. dollar (approximately 43%) was within one standard deviation away from the mean undervaluation among a random sample of 45 currencies (see Fig. 1). The fact that China tends to get singled out in Congress for its currency stance raises suspicion that perhaps "currency manipulation" bashing has less to do with the degree of undervaluation and more to do with the influence interest groups exert in Congress. Thus, one of the two objectives of this paper is to answer the question: To what extent do interest groups influence legislators to bash China for its exchange rate management policy?

The second objective of this paper is to understand the consequences of such bashing on the rate at which the RMB appreciates against the U.S. dollar. Both objectives reinforce each other, which is why they are analyzed in one paper. Knowing why bashing occurs is important because of the consequences that it may have.

To answer the first question posed above I use a standard political economy model that explains the frequency with which members of Congress bash China through "currency manipulation" criticisms in the 111th Congress (2009–2010). Specifically, I count the number of times each congressmen voiced the particular keywords "currency manipulation" in the context of China. I then fit a regression of this count on the amount of money congressmen received from interest groups that were in favor of enacting the "Currency Reform for Fair Trade" bill (H.R. 2378), controlling for other factors known to influence legislative voting behavior, such as ideology, party affiliation, constituent interests, and how they voted on H.R. 2378.

The results of this first test are consistent with expectations. I find that PAC money from groups that supported the enactment of the September 2010 bill is one of the most important determinants of congressional China bashing. A $5000 payment from these groups is associated with legislators being 1.35 times more likely to criticize China for being a "currency manipulator."

As indicated, the second objective of this paper is to evaluate whether currency manipulation bashing has worked. Presumably, its ultimate objective is to make China abandon its current exchange rate management policy, or at least let it appreciate against the dollar some 20 to 40%, if not more. Therefore, it seems pertinent to investigate how this bashing influences the Chinese renminbi, if at all. To accomplish this objective, I create a bashing index based on the total count of "currency manipulation" news reported in major U.S. newspapers from January 2000 through December 2010. I then test whether the recent nominal appreciation of the Chinese RMB against the U.S. dollar can be linked to the currency manipulation bashing index. If bashing works, one would expect to observe a positive relationship between this index and the rate at which the RMB has appreciated.

The results of the second test suggest that bashing appears to influence the nominal exchange rate for about 3 months, but perhaps not in the direction the U.S. would favor. The relationship between bashing and the rate at which the RMB appreciates, although temporary, is overall negative. This result implies that bashing may actually be counterproductive: the more of it there is, the less likely that it will work.

The rest of the paper is summarized as follows: Section 2 describes in more detail the construction of the currency manipulation count for each legislator. It also provides information regarding the data sources used in the first test. Section 3 presents the political economy model and the regression specification. Section 4 discusses the empirical findings of the first test. The second question addressed in this paper is discussed in Section 5. Part A addresses the data underlying the construction of the China "currency manipulation" bashing index, which is used in the VAR model (discussed in Part B). That section also discusses the empirical results of the VAR model. Section 6 offers some concluding remarks.

2. First test: data

As indicated in the introduction, the first objective of this paper is to understand the effect that PAC money may exert on a legislator's incentive to bash China for its exchange rate management policy. This test requires a quantifiable measure of legislator-specific currency manipulation bashing. To develop such measurement, I use the Factiva search engine to count the number of media articles that contain the following keywords: "China" and "currency manipulation" or "currency manipulator" or "exchange manipulation" or "exchange rate manipulator" and that also included the legislator's name.[2] The coverage period for this count is from January 3, 2009 (the first day of the 111th Congress) to August 31, 2010 (the last day of the last month before the House voted on H.R. 2378, the "Currency Reform for Fair Trade Act"). This procedure resulted in a discrete count of articles for each legislator in the 111th Congress.

As one would expect, the distribution for this count variable is skewed. Nearly 45% of the legislators have a count of 0 articles, 13% of them have a count of 1, 7.6% a count of 2, and 7.9% a count of 3. The remaining 26.6% are scattered among cells of 4 or more articles, with the highest one having a count of 154.[3]

The next set of variables that need to be included in the model are, of course, contributions from PACs to individual legislators, as well as other variables known to influence congressional voting behavior, such as ideology, party affiliation, and constituent interests. The motivation for including these variables is based on previous Congressional voting behavior research. This literature

[1] The vast majority of these papers argue that the RMB is undervalued by some 20 to 40%. Whether a revaluation of the RMB or even adopting a flexible exchange rate regime will help to correct the U.S.–China trade imbalance is still in dispute. For more on this issue see Cheung, Chinn, and Fujii (2010) and Chinn and Wei (forthcoming).

[2] To minimize the retrieval of irrelevant articles, I performed multiple permutations of the legislator's name (e.g. last name only, last name and first name, last name and nickname, last name, first name, and nickname, last name and first name initial) and also included the district and state that he or she was representing. I then selected those that correctly identified the legislator.

[3] This legislator is Sandy Levin (D-MI, 12th Congressional District), who served as Chair of the Trade Subcommittee during the 111th Congress, and has been an outspoken critic of China's currency policy. See: http://thehill.com/business-a-lobbying/112967-dems-ready-to-push-china-on-currency-manipulation?page=2.