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FACT OF THE WEEK

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How a persistently undervalued currency distorts investment flows and sends U.S. jobs offshore

A persistently undervalued currency affects investment as much as it does trade. For example, China's persistently undervalued currency encourages investment in China at the expense of investment in the United States. This has the direct result of sending American jobs offshore.

When a currency is undervalued, investors with dollars, euros, or other currencies, rent land and purchase equipment for less in that country than the same activities would cost in other countries that do not undervalue their currencies. As a hypothetical, let's say it would cost 4 billion RMB to build a steel mill in China. At current exchange rates, this mill would cost an investor around \$586 million dollars. If the RMB were allowed to rise to its fair value on the open market, however, that same mill would cost approximately \$900 million, an increase of more than \$300 million. This savings is purely the result of the Chinese government maintaining the misalignment of currency.

There can be no question that maintenance of persistently undervalued currencies by China and others has contributed to the loss of investment in the United States. According to U.S. Bureau of Economic Analysis, inflation-adjusted Gross Private Domestic Investment (GPDI) in the United States totaled \$1.5 trillion in the third quarter of 2009. This figure represents \$586 billion decline from the first quarter of 2008. It also is lower than \$1.54 trillion U.S. GPDI for the second quarter of 1997, meaning that more than a decade of real U.S. investment growth has been wiped out in less than two years!

In comparison, China reported to the International Monetary Fund (IMF) that its Gross Fixed Capital Formation more than quadrupled; from 2.597 trillion Yuan in 1997 to 10.522 Trillion in 2007. The web publication *China Daily* reports that fixed asset investment in China rose another 27 percent in 2008 – which would bring it to 13.4 trillion Yuan – a five-fold increase. In 2009, investment is reported to be rising another 25 percent. Thus, even with the slight inflation in fixed investment over this period, China's real gross investment has roughly quintupled over the past 12 years while investment in the United States has fallen.

Of course, the ability of the United States to remain competitive internationally depends on American companies using and developing the most modern and efficient equipment. Absent this investment, American companies and their workers become less competitive. In the most extreme cases, rather than upgrading their facilities in the United States, companies simply shut down operations here, and build a new plant in places like China. For reasons like this, more than 5.5 million Americans in manufacturing have lost their jobs.

An undervalued currency does more than “just” cost American jobs. By discouraging investment in the United States, these policies sap our long-term competitiveness. Ultimately, the damage these policies inflict on our manufacturing base and other economic sectors will hurt U.S. growth and even our national security. That's why Congress must pass H.R. 2378 and S. 1027, the Currency Reform for Fair Trade Act, without delay.

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