Submission for the record
by Hugh J. Campbell, Jr. CPA,

Hearing on
China's Exchange Rate Policy

Committee on Ways and Means
U.S. House of Representatives

September 15, 2010

Executive Summary

The Committee's announcement of the Hearing on China's Exchange Rate Policy raised the following issues which this submitter chooses to comment on:

Whether China's June announcement to allow exchange rate flexibility has led to material appreciation of the renminbi (RMB)?

Exchange rate levels as of the date of the hearings will best answer this questions.

Whether Congress or the Administration should take action to address China's unfair currency policy and its impact on U.S. businesses and workers?

This submission will offer the Committee an Inflation-Neutral Balanced Trade System (BTS), which will address America's Growing Trade Deficit with a Balanced Trade model, which was the essence of Warren Buffett's November 2003 Fortune article. Since **ARTICLE XII of GATT 1994, RESTRICTIONS TO SAFEGUARD THE BALANCE OF PAYMENTS** permits members to restrict the quantity or value of merchandise permitted to be imported, in order to safeguard its external financial position and its balance of payments, the Congress and the Administration should act swiftly to legislate provisions to mitigate the years of adverse impact to U.S. businesses/workers and very likely ward off adverse impact to American consumers, as the result of China's progress toward obtaining global monopolies in multiple industries.

Chairman Levin's comment in the Hearing announcement follows:

"There is no real question that China's deliberately undervalued exchange rate is unfair, contributes to global trade imbalances, and costs the United States jobs and economic growth, particularly in the manufacturing sector. We must ensure that China's rhetoric translates into results that are meaningful and that the international trading system ensures fair rules of competition."

To the aforementioned comments, the submitter would like to add:

The trade deficits and the globalization drain have contributed significantly to the 25% + decline in U.S. Tax revenue as a percentage of Gross Domestic Product (GDP) for 2009 versus 2000; they have caused both monetary and fiscal stimulus efforts from 2001 through 2009 to be much less effective than they would have otherwise been with a Balanced Trade environment and if allowed to continue will like to make most future stimulus much less effective.

The last 7 years of hollow rhetoric from China speaks volumes and is very telling regarding their intentions and agenda. During the 2005 – 2008 period when China allowed the U.S. Dollar the decline by approximately 20% the HANG SENG INDEX declined by approximately 60%. How likely is it that China will be willing to let the U.S. Dollar decline by substantially more than 20 % over a 3 year period? In addition, during the latter part of the aforementioned 2005 – 2008 period, U.S. exports to China did not increase commensurate with the magnitude of the U.S. dollar decline. Non-currency related mercantilist protectionist practices appear to have been stepped up to offset the dollar decline. Strong legislation, that will not adversely impact American consumers on a net basis, will enable the U.S. to regain an equal seat at the table of global trade.

In addition to discussing legislation, such as the Currency Reform for Fair Trade Act (H.R. 2378) and the initiation of formal dispute settlement consultations with China within the World Trade Organization, in these recessionary times, the submitter hopes that The Committee considers a Balanced Trade model, which strongly and favorably impacts U.S. businesses/workers and yet has a non-inflationary effect, on a net basis on American consumers. In the book I.O.U.S.A. Warren Buffett warns that persistent trade deficits may create real political instability down the line, and increase the possibility that demagogues come along, with very superficial arguments and do some very foolish things.

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September 15, 2010, continued

In November 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,*** by Warren E. Buffett was published in Fortune and can be found at:

The aforementioned link is the only non-Berkshire Hathaway link on its Web Site and speaks to the degree of concern of the trade deficit has to Buffett, an even greater concern than the Budget Deficit. One of the primary themes of the article is a Balanced Trade as opposed to a Free Trade or a Fair Trade. The following four excerpts speak volumes regarding Mr. Buffett's passions against U.S. Trade Deficit:

Buffett 2003 article paragraph:

The time to halt this trading of assets for consumables is now, and I have a plan to suggest for getting it done. My remedy may sound gimmicky, and in truth it is a tariff called by another name. But this is a tariff that retains most free-market virtues, neither protecting specific industries nor punishing specific countries nor encouraging trade wars. This plan would increase our exports and might well lead to increased overall world trade. And it would balance our books without there being a significant decline in the value of the dollar, which I believe is otherwise almost certain to occur.

2008 *I.O.U.S.A.* book interview Q & A:

Q: What do you say to people who say, "Oh economic matters are too complicated, and I can't figure it out"? Why should the average American try to get a handle on these matters? Why is it important?

Warren Buffett: I think it's very tough for the average American to understand economics well, just as it's tough for them to understand physics well. It's a subject that requires some experience and thought and a fair amount of interest. And, as a practical matter, a high percentage of the population probably will not be interested in economics any more than they are in meteorology or physics or biology. Because it's important it does not mean that hundreds of millions of Americans are going to understand it well. And of course the real problem is that they all have this indirect, passing interest in it, and demagogues of various sorts can scare them with economics because it does apply to their everyday lives. But since the average American doesn't usually have the ability to, or even the interest in thinking incisively about the question, they can be subject to very superficial arguments.

Q: Is there a way to correct the trade path that we're on, and if so, what is it?

Warren Buffett: It's complicated. I reluctantly think that it probably requires some governmental policies that will lead to imports and exports actually increasing, but coming much closer to balancing imports and exports. I think that's advisable. I don't think the world comes to an end if it doesn't happen this year or next year, but piling up more and more and more external debt and having the rest of the world own more and more of the United States may create real political instability down the line, and increase the possibility that demagogues come along and do some very foolish things.

Warren Buffet on the Trade Deficit - I.O.U.S.A. Video Clip:

2006 Chairman's Letter - BERKSHIRE HATHAWAY INC

As our U.S. trade problems worsen, the probability that the dollar will weaken over time continues to be high. I fervently believe in real trade – the more the better for both us and the world. We had about $1.44 trillion of this honest-to-God trade in 2006. But the U.S. also had $.76 trillion of pseudo-trade last year – imports for which we exchanged no goods or services. (Ponder, for a moment, how commentators would describe the situation if our imports were $.76 trillion – a full 6% of GDP – and we had no exports.) Making these purchases that weren't reciprocated by sales, the U.S. necessarily transferred ownership of its assets or IOUs to the rest of the world. Like a very wealthy but self-indulgent family, we peeled off a bit of what we owned in order to consume more than we produced.
The U.S. can do a lot of this because we are an extraordinarily rich country that has behaved responsibly in the past. The world is therefore willing to accept our bonds, real estate, stocks and businesses. And we have a vast store of these to hand over.
These transfers will have consequences, however. Already the prediction I made last year about one fall-out from our spending binge has come true: The "investment income" account of our country – positive in every previous year since 1915 – turned negative in 2006. Foreigners now earn more on their U.S. investments than we do on our investments abroad. In effect, we've used up our bank account and turned to our credit card. And, like everyone who gets in hock, the U.S. will now experience "reverse compounding" as we pay ever-increasing amounts of interest on interest.
I want to emphasize that even though our course is unwise, Americans will live better ten or twenty years from now than they do today. Per-capita wealth will increase. But our citizens will also be forced every year to ship a significant portion of their current production abroad merely to service the cost of our huge debtor position. It won't be pleasant to work part of each day to pay for the over-consumption of your ancestors. I believe that at some point in the future U.S. workers and voters will find this annual "tribute" so onerous that there will be a severe political backlash. How that will play out in markets is impossible to predict – but to expect a "soft landing" seems like wishful thinking.

Since the 2003 Buffett article, trillions of dollars U.S. Trade Deficits have flowed under the globalization bridge, the degree of variation of U.S. Trade Deficits with different trading partners has increased immensely and potential unintended consequences of an import certificate trading model have been identified. For these reasons and the current stress on U.S. Consumers, the submitter has taken the liberty to modify the 2003 Buffett Import Certificate Plan to become an Inflation-neutral Balanced Trade System (BTS).

The Chinese Government deserves a huge amount of credit for its creativity in implementing a veiled form of protectionism versus a blatant form of protectionism, like a tariff. Veiled protectionism allows many in the U.S. to engage in "plausible denial" regarding whether currency manipulation is actually protectionism. Currency manipulation is actually one the most potent form of protectionism since it is both offensive (it makes the manipulating county's exports cheaper) and defensive (it makes imports from the country whose currency is manipulated more expensive). The submitter contentions that the Chinese Government has been manipulated the U.S. Dollar when it wished to maintain a peg between its currency and the U.S. Dollar. By comparison if a foreign government was manipulating, the U.S., radar systems or water systems Americans would have united and such manipulations would not have been allowed to go on for seven years.

The Americans for Tax Reform's blog posting, ***Pressuring China Would Hurt U.S. Consumers*** makes very good objections to standing up to China, but all these arguments evaporate with the Inflation-neutral Balanced Trade System (BTS) proposed herein. The ATR blog posting can be found at:

The 2003 Buffett article contains comparative graphs captioned: Truth and consequences, Facing up to the effects of our trade imbalance (within the graphs is the following quote): "Huge and growing U.S. trade deficits …are inevitably putting an ever larger slice of America in foreign hands. The seriousness of persistent trade deficits is acknowledged by World Trade Organizations (WTO) in **The General Agreement On Tariffs And Trade, Article XII Restrictions to Safeguard the Balance of Payments**, which can be found at:

ARTICLE XII of GATT 1994, RESTRICTIONS TO SAFEGUARD THE BALANCE OF PAYMENTS permits members to restrict the quantity or value of merchandise permitted to be imported, in order to safeguard its external financial position and its balance of payments. Quantitative and other trade measures for balance-of-payments purposes, including import surcharges and import deposit schemes.

In view of acknowledged seriousness of persistent trade deficits by Warren Buffett and the WTO and the quantitative remedies sanctioned by **ARTICLE XII of GATT 1994** the submitter details an **Inflation-Neutral Balanced Trade System (BTS), inspired by Warren *Buffett's 2003 Import Certificate Plan*,** as follows:

The merits of Warren Buffett's 2003 Import Certificate Plan:

- It strives for what global trade's aim should be, namely, the optimization of "comparative advantage", through balanced trade.
- It is flexible, i.e., it dynamically readjusts based on improving/deteriorating trade surpluses/deficits.
- It is sustainable because balance and rebalancing is the heart of the system.
- It preempts the number one enemy of fair trade, i.e., stakeholders attempting to game the system to enhance their own "absolute advantage" at the expense of "comparative advantage".
- Unlike fixed tariff plans, it makes retaliation self-defeating with its rebalancing based on the import/export gap.
- If it had been adopted 6 years ago, global trade would be vastly closer to achieving Balance Trade.

Suggested Modifications to the Buffet Plan

- Substitute for tradable import certificates, a consumption/sales tax on imported goods or only imported manufactured goods.
- Ideally, the consumption/sales tax percentage should be country-specific, since the balance-of-payments imbalances are country-specific; with the initial roll-out on imports from countries with whom the United States has the largest trade deficits on a percentage basis and possibly be ramped-up over as long as five years (Phase 1).
- To initially expedite implementation, the revenue generated from the consumption/sales tax would be redistributed back to U.S. consumers as a general state sales tax or other tax credit based on state sales tax patterns. A later phase (Phase 2) of the BTS could provide consumption credits on the purchase of domestic manufactured goods (replacing the general sales tax credit). At some point, the revenue generated from the consumption/sales tax could be redistributed only to U.S. exporters of manufactured goods (Phase 3); at which time the BTS would cease to be inflation-neutral but it would provide manufacturing exporters the same benefit as the Buffett Import Certificate Plan.
- The consumption/sales tax and related general sales tax credit would be reset annually, based on the United Sates' previous year country-specific current balance-of-payments. This annual resetting will provide a form of free-market virtue comparable to Buffett's 2003 Import Certificate Plan. If the country-specific current balance-of-payments shrinks to zero or a sustainable level, the consumption/sales tax and related general credit would be eliminated for the upcoming year.
- Imports that are subject to a carbon assessment/tax, these imports should be excluded, since the carbon assessment/tax will cover these imports.
- Domestic manufacturers that use imported components can apply for rebates of the consumption/sales tax, if the manufactured item is exported.
- If certain counties which the U.S. runs meaningful trade deficits are to be exempt, the exemption should be viewed as a form of foreign aid and reevaluated annually.

Advantages of Modifications

- An import consumption/sales tax versus tradable import credits would avoid potential fraud/abuses arising from trading import credits and their related transaction costs.
- Levied as a consumption/sales tax would preclude gross profit mark-ups by sellers and the resulting higher cost to consumers. The BTS is a zero-sum system to the U.S. Consumer; it is both inflation-neutral to the consumers and revenue-neutral to the federal government, i.e., No New Net Tax.
- Country-specific percentages, based on the current balance-of-payments, would act as a direct enforcement mechanism against currency manipulation, as well as other mercantilist protectionist practices.

- The redistributed back to U.S. consumers as a credit would eliminate the inflation effect that would otherwise result from the import certificates model or other tariff plans.
- The resetting of percentages annually bases on current balance-of-payments is consistent with free-market virtue and provides immunization against retaliation.
- The United States could address it balance-of-payments challenges without allowing or forcing the depreciation of the U.S. Dollar.
- Since domestic manufacturers can receive rebates, if the manufactured item is exported, U.S. manufactured exports will not be burdened by the BTS and therefore will remain competitive.

Conclusion

To date, Americans have been unable to unite behind a balanced and sustainable global trade policy. One reason could be that U.S. consumers have been the front-line beneficiaries of the competitive prices of many imports to comparable domestic products. Since the **Balanced Trade System (BTS)** levels the playing field for many domestic products, but not on the backs of consumers (Inflation-Neutral and No New Net Tax); the Legislature/Administration has a unique opportunity to exercise new found courage and address our unsustainable pseudo-trade problem.

The submitter's executive summary mentioned China's progress toward obtaining global monopolies in multiple industries, a comment rooted in concerns sparked by a Bloomberg April 2007 article ***China's Power Erodes Free-Trade Support in Developing Nations***, which mentioned local industries, even in developing countries, being forced out of business. The Bloomberg article can be found at**:**

Concerns were increased significantly by the Wall Street Journal November 2008 article ***China Defends Price Fixing by Vitamin Makers***, which can be found at:

Because China is a communist country it is able to dictate to its business firms. When dictating increase prices, China contends that its price fixing actions are exempt from prosecution in foreign courts under the doctrine of sovereign immunity, just like OPEC. If the doctrine of sovereign immunity was upheld, once a communist country's business firms obtained monopolistic market share, much higher prices could be changed on exports creating a "perfect storm" for U.S. consumers. Where the doctrine of sovereign immunity is not available, higher prices would normally be obtained through rising exchange rates, which in China's case would make all their exports more expensive, make U. S. exports to China less expensive and make China's holding of U.S. financial assets worth less. An ability to play the sovereign immunity card would provide China the best of all worlds and America the worst of all worlds.

The closing two questions to a 2010 Consumers Union Activist Summit presentation were regarding quality/safety issues, multiple-industries monopolies and a potential "perfect storm" for U.S. consumers". This presentation can be found at:

Click the (CU Summit 2010: Eric Schlosser link) and start at 40:30.

The quality/safety issues cannot be underestimated, based on the Guardian News and Media July 2010 article, ***BP oil spill: failed safety device on Deepwater Horizon rig was modified in China*** - Blow-out preventer was sent to Far East at BP's request rather than overhauled in US

Currency manipulation is mentioned during Ford's CEO, Alan Mulally's Q & A remarks at the 2010 National Governors' Association Winter Meeting "***Let's Start by Making Manufacturing a Priority"***, starting at 53:00 of the video at the link that follows:

Alan Mulally's Q & A on trade ends at 57.10, with the following text:

Another really big one is, let the markets determine the currency, the currency exchanges. This currency manipulation is just a killer. I mean, we all know exactly what their countries around the world are doing. They're targeting manufacturing. They undervalue their currency so they can make things, and we can't. Right? Are we talking to each other here? We have got to have a real based trading around the world. And it's not like it's far away from each of you. You are the CEOs of these fabulous states, and our ability to compete worldwide means that we, the United States, have got to keep pushing to real based trading, so that we have access to the markets, we have access to capital, and that we have free trade agreements that allow that to happen with no distortion on the currency.

So those would be the big ones.

In all likelihood the testimony the committee will receive will be split over what the economic impact of a trade. Somewhere in the middle of extremes is one of the world's richest man, Warren Buffett. He believes that, on a whole, trade is a good thing for America, but that over the long term, running "large-and-persistent" trade imbalances will be problematic for the United States.

The submitter believes that since 2003 the U.S. Legislatures and Administrations have been distracted by the Iraq War and primarily for this reason have not addresses the trade deficit but he has the upmost confidence that China's creativity will be match by American creativity, if the current Congress and The Obama Administration levels the playing field for all Americans by enacting a Balanced Trade model before the 2010 mid-term election.

Respectfully submitted,

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