CEPR Fact Sheet
The Dollar

ECONOMICS AND THE ELECTIONS

Losing Jobs to an Over-Valued Dollar

There has been considerable debate over the impact of NAFTA and other recent trade agreements on jobs. While the impact of these agreements has been important, the over-valued dollar has almost certainly been a far more important factor in losing American jobs. Over the last decade, the United States has lost more than 3.8 million manufacturing jobs.

An over-valued dollar effectively imposes a tariff on the goods we export to other countries. This makes the goods we produce more expensive to people living in other countries, so they will buy less of our exports. At the same time, an over-valued dollar effectively provides a subsidy for goods we import, making them cheaper for us to buy than domestically manufactured goods. This increases our imports. With lower exports and higher imports, an over-valued dollar raises the U.S. trade deficit by lowering exports and increasing imports.

These effects can be seen by examining how we pay for imports and how foreigners pay for our exports. Suppose we are considering buying a car that can be produced in Germany and shipped to the United States for 20,000 euros. If the euro is very low, as it was in 2002 when it was worth just a bit more than 80 cents, then this car will be relatively cheap for people living in the United States. When a euro is worth just 80 cents, it will cost us $16,000 to buy a car that sells for 20,000 euros (20,000 times 80 cents).

Now, a euro is worth more than $1.50. If we want to get 20,000 euros to buy the same car, it will cost us $30,000. As a result of the euro rising in value against the dollar from being worth just over 80 cent to being worth more than $1.50, the price of the car rose from $16,000 to $30,000 (20,000 times $1.50). At the more expensive price, many fewer people will buy the car.

The situation works in reverse on the other side. Suppose that Boeing wants to sell airplanes to Europe that cost them $20 million each to produce. If the euro is worth just 80 cents, then an airline in Europe would have to pay 25 million euros to buy a airplane from Boeing (20 million divided by 0.8).

However, if a euro is worth $1.50, then Boeing's airplane will cost a European airline just 13.3 million euros (20 million divided by 1.5). When the dollar falls in value relative to the euro, the airplane becomes much cheaper for European airlines to import. (These examples are summarized in **Table 1**.)

This point applies to all imports and exports. If the dollar rises by 25 percent against the currencies of our trading partners, then this means that the goods that we import from them will be roughly 25 percent cheaper for people living in the United States. This is similar to a situation in which the government paid everyone a subsidy equal to 25 percent of the price of any goods they imported. Naturally, this will lead people to buy more imported goods.

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TABLE 1
The Value of the Dollar and the Cost of Imports and Exports

	Euro = 80 cents	Euro = $1.50
Cost of 20,000 euro car in dollars	$16,000	$30,000
Cost of $20 million airplane in euros	25 million euros	13.3 million euros

Source: Author's calculations, see text.

At the same time, the higher priced dollar will make our exports to other countries approximately 25 percent more expensive. This is comparable to the government imposing a tax of 25 percent on all the goods that we export from the country. This would naturally cause our exports to fall.

This is especially important for income distribution because the workers who are exposed to international competition are disproportionately non-college educated workers in the manufacturing sector. By increasing our trade deficit and reducing employment (and wages) in manufacturing, a high dollar policy is effectively redistributing income from less educated workers to more highly educated workers (especially professionals like doctors and lawyers) who are still largely protected from international competition. The downward pressure on wages and employment in the manufacturing sector, which was heavily unionized, has also contributed to the unprecedented wage stagnation for non-college-degree workers (about 70 percent of the labor force) over the last 30 years.

Dollar Policy

The Clinton and Bush administration had policies of actively promoting, or at least tolerating, an over-valued dollar. This led to the record trade deficits of recent years. The dollar has recently been declining, at least partly as a result of these trade deficits. Trade deficits put dollars in the hands of foreigners; if they don't want to hold them (and often they don't), then they sell their dollars on world markets. The selling of more dollars on world markets lowers the price of the dollars, just as selling more oil, corn, or any other product will lower its price. Because of the large trade deficit, the dollar is likely to continue to lose value for the foreseeable future.

The government could adopt a policy of trying to push down the dollar or keep the dollar low, thereby reducing imports, helping our exports and keeping our trade balance in check. Ideally, the United States could negotiate with our major trading partners to have our central banks work together to try to bring the dollar down to a lower level. This would mean, for example, that the European central bank, the Chinese central bank, and the Fed would work together to sell dollars in international currency markets to bring the dollar down to an agreed upon level.

If we couldn't get an agreement on a lower value of the dollar, the United States could act on its own to push down the value of the dollar. In principle, the government and the Fed could sell as many dollars as they want on international currency markets. At some point, the United States could put enough dollars into these markets to force down the price. This lower priced dollar would then make it easier for U.S. exporters to compete internationally and for domestic producers to compete in our own market.

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The United States could push down the dollar even against currencies that are pegged to the dollar like the Chinese yuan. If efforts to negotiate a lower value of the dollar proved unsuccessful, the Treasury Department, with the support of the Fed, could simply announce that it was creating its own official exchange rate that valued the yuan higher than the rate set by the other country.

For example, the Treasury Department could announce that we would accept 6 yuan to the dollar, which would give the yuan a considerably higher value than the rate of 7.1 yuan to the dollar currently supported by the Chinese government. If the Chinese government insisted on trying to maintain its over-valued currency, it would end up wasting enormous amounts of money by paying too much for dollars and holding trillions of dollars for which it has no use. Presumably China would agree to negotiate a lower value of its currency before it lost too much money on such an exercise.

Unfortunately, the value of the dollar is almost never discussed in the context of economic policy or even trade policy. There are few policy changes that would have more impact on the overall economy and the distribution of income, and probably none that would have more impact on trade, than a substantially lower-valued dollar.