A Descriptive Study on the Impact of Currency Manipulation upon the Competitive Advantage over International Trade, With Respect To Conditions in South Korea

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Abstract: **Studies related to currencies round the world, always shows a negative aspect on fall in value of currency. Devaluation of currency is the official lowering of value of currency related to another currency or group of currencies. Currency manipulation of currency is a rising foreign exchange risk faced by major players in international market. Federal Reserve Bank of New York has identified currency manipulation of currency by international trade player China. Currency devaluation has a significant effect on foreign exchange transaction and has an impact on trade between the countries. Currency devaluation targets advantages of cost upon import and export of goods and services between the countries. Study focused on a close watch on the factors considered by nations on devaluation of currency and significant impact on import and export transactions of nations.**

INTRODUCTION

Devaluation of currency is the official lowering of the value of currency with a fixed exchange rate system, by which the monetary authority formally sets a new rate with respect to a standard foreign currency. Various factors affecting the change in value of currency includes Balance of payment, strength of economy, political situations, interest rates, inflations, fiscal policies, monetary policies, central bank interventions, export policies, import policies etc. Devaluation process is artificially created by certain countries round the world for achieving various competitive advantages over trade practices. Currency value plays a dominant role in export and import behavior of countries. Countries under value their currencies to achieve a competitive advantage in foreign trade. IMF has directed various trade governing bodies to avoid manipulation of exchange rates for achieving competitive advantage in trade between countries.

Bretton Woods Conference in July 1944 introduced the concept of fixed exchange rate system for stabilizing the economic environment. US played a dominant role with the value of other currencies fixed in terms of dollar and value of dollar with gold reserves. Gold standards came to an end by 1973 and from then onwards most of the countries start focusing on floating exchange rate system. Two implications of devaluation of currency include, exports become cheaper and imports become costlier.(York, 2011)

US Treasury have specified offices to identify currency manipulators among the trade partners. There are several other countries who nearly meet the US Treasury Department's definition of a currency manipulator. US call countries who manipulate currency as Currency manipulators. The Treasury Department releases semiannual reports on the foreign exchange policies of major trading partners. US mainly considers three important factors for the categorization of a trading partner as currency manipulator and the factors includes, country have a significant trade surplus with US, country is having a “material” current account surplus with the US and Be engaged in "persistent, one-sided" intervention in the foreign exchange market. Thailand, South Korea, Japan and India all met two out of three of those criteria in 2017 for the currency manipulation. (Insider, 2018)

In this study we have worked to know the impact of devaluation upon the competitive advantage of various countries down the world. Devaluation enables countries to attract more international buyers to the domestic products and markets. Currency value being an important determinant of foreign trade practices brings out various shifts in balance of payment and other economic factors. Currency manipulations will leads to more foreign intervention to the domestic market of a country. Currency manipulations also brings costlier imports and thereby leads to radical reduction in imports from different countries. Import sensitive goods will find a poor acceptance from the trading partners who are into currency manipulations.

Conflicts over currency valuations are a recurrent feature of the modern global economy. To strengthen their international competitiveness, many countries resort to buying foreign currencies to make their exports cheaper and their imports more expensive. In the first decade of the 21st century, for example, China's currency manipulation practices were so flagrant that they produced a backlash in the United States and other trading partners, prompting threats of retaliation. The book is an indispensable guide to a complex and serious problem and what might be done to solve it.(Gagnon, 2017)

A metallic standard appears as an obstacle to all attempts to interfere with the market phenomena by monetary policies. The first objective of redemption is to secure the stability of foreign exchange rates. The United States was in 1933 by and large still under the classical gold standard. This fact did not stop the New Deal's inflationism. (Bloomberg, 2018) (Bloomberg, 2018)One of the main objectives of currency devaluation--whether large-scale or small-scale--is, as will be shown in the next section, to rearrange foreign trade conditions. These effects upon foreign trade make it impossible for a small nation to take its own course in currency manipulation irrespective of what those countries are doing with whom its trade relations are closest. The characteristic feature of the flexible standard is that any amount of domestic money-substitutes can in fact be exchanged at the parity chosen against gold or foreign exchange, and vice versa. At this parity the Central Bank (or whatever the name of the government agency entrusted with the task may be) buys and sells any amount of domestic currency and of foreign currency of at least one of these countries which themselves are either under the gold standard or under the flexible standard. (Mises)

Real wars have guns, and trade wars are fought with weapons such as tariffs. Currency wars, on the other hand, are stealth battles — no country ever admits that it’s waging one. A weaker currency means a country’s exports can be sold cheaper overseas, providing a jump-start to the economy at home. The most famous frenzy of competitive devaluations came during the Great Depression of the 1930s, as countries abandoned the gold standard that had pegged their currencies to the value of the metal. Until its collapse in 1971, the Bretton Woods system prevented a repeat of such beggar-thy-neighbor strategies by linking the value of many currencies to the U.S. dollar. Trump targeted the country's exchange-rate regime during his presidential campaign in 2016, even though by that point China had shifted to a policy of propping up the currency to stem capital flight. With the explosion of global trade tensions, the U.S. and other countries might be more willing to consider their currencies as leverage and shift the fight to the foreign-exchange markets. (Bloomberg, 2018)

Objectives of the Research

- To know more about the currency manipulation of currency
- To analyse various conditions prevailed in South Korea and the categorization of currency manipulation of currency

Scope of Study

The study focuses on the currency manipulation of currency and the competitive advantage of nations over international trade. Scope of the study is limited to the trade practices and current economic conditions of South Korea.

Research Methodology

Study is conducted on secondary data and the information is collected from various sources. Various charts regarding the current economic conditions of South Korea is analyzed to know about the currency manipulation of currency.

Statement of Problem

This study is conducted to find whether South Korea is a currency manipulator by considering the determinants of IMF and WTO and the effects of currency manipulation.

Limitation of Study

Study has conducted on the basis of only a few variables. Intensive study with other variables should be conducted to get accurate results.

Theoretical & Data Analysis with respect to South Korea

Study has taken the data of South Korea to analyze the currency movement with respect to the determination of currency manipulation criteria given by IMF and WTO. Criteria involve:

- Did Country X have more exports than imports over a set six-month period?
- Did Country X add to its foreign exchange reserves over that same six-month period?
- Are Country X's foreign exchange reserves more than sufficient to cover the average of imports within a three-month period?

Current Account

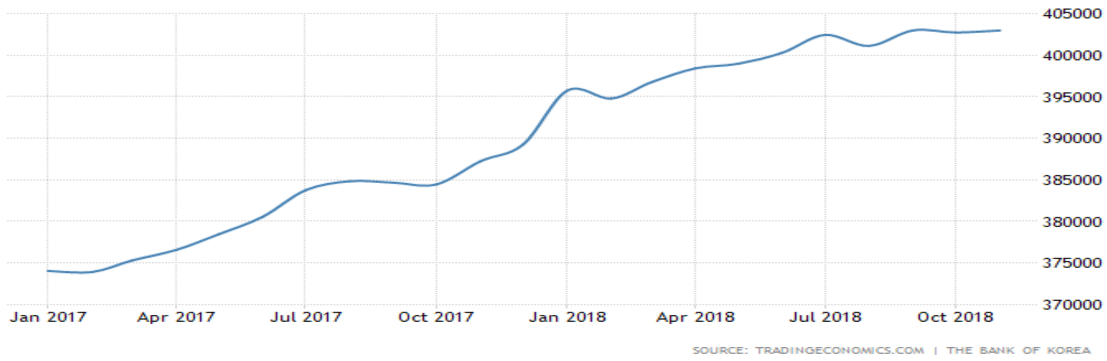
According to BOP approach on exchange rate behavior proposed by Allen and Kennen, an increase in inflow of foreign exchange enhances the value of domestic currency against foreign currency which means the currency of a country with trade surplus should be high.

South Korea's current account surplus widened sharply to USD 9.19 billion in October 2018 from USD 5.72 billion in the same month the previous year. The goods account surplus widened to USD 11.00 billion from USD 8.60 billion a year ago, whereas the primary income surplus narrowed to USD 0.96 billion from USD 1.17 billion. Meantime, the services account deficit narrowed to USD 2.22 billion from USD 3.53 billion, whereas the secondary income gap widened to USD 0.54 billion from USD 0.52 billion. Considering January to October, the current account surplus narrowed modestly to USD 66.87 billion from USD 66.94 billion in the corresponding period 2017. Current Account in South Korea averaged 1572.11 USD Million from 1900 until 2018, reaching an all-time high of 12287.50 USD Million in September of 2017 and a record low of -3756.80 USD Million in August of 2008.

Analysis of above current account values identifies that, South Korea is having good trade practices and have achieved, trade surpluses over a period of more than six months. Even though with the favorable condition of trade surplus, currency value is undervalued and hence we can conclude that first condition for categorizing as a currency manipulator is satisfied by having high trade surplus.

Foreign Exchange Reserve

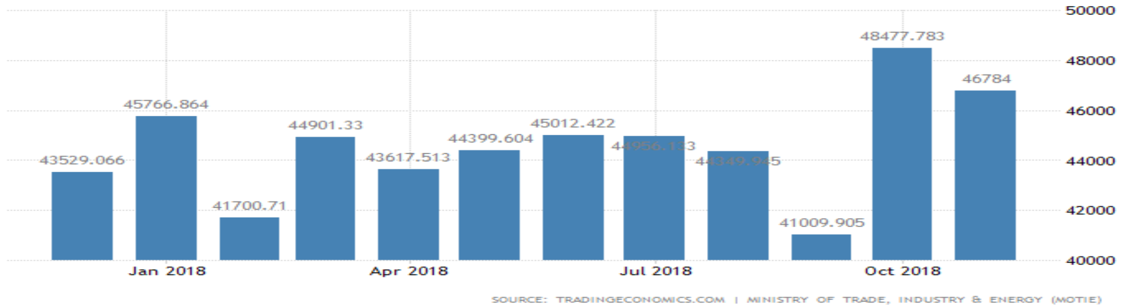
Increased Foreign exchange reserves can stabilizes the currency of a country and could have an appreciation in value of currency.



As per the above graph its quiet clear that Korea is having a growing foreign exchange reserves for more than a period of one year. Above data shows an increase of 107% in foreign exchange reserves. South Korea has a steady growth in foreign exchange reserves right from a lower level of 374000 to an advanced level of 403000.

Analysis of above foreign exchange values identifies that, South Korea is having high growth in foreign exchange reserves over a period of more than six months. Even though with the favorable condition of foreign exchange reserve, currency value is undervalued and hence we can conclude that second condition for categorizing as a currency manipulator is satisfied by having high foreign exchange reserves.

Imports of South Korea



As per the IMF and WTO third criteria, foreign exchange reserves for a country should not be more than three month average of the import of the country. As per above graph, last three quarter's average of imports will come up to 134538.2. Foreign exchange reserves of the country as on last quarter is 403000, which is 50% (268461.8 Million Dollars) more than standard reserves of average of imports of the country; hence we can conclude that third condition for categorizing as a currency manipulator is satisfied by having high foreign exchange reserves with respect to the three month average of imports.

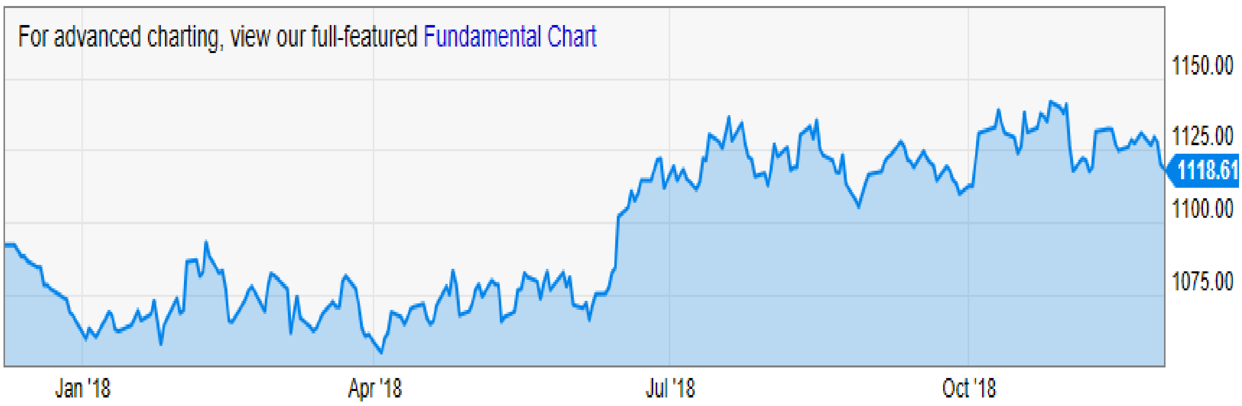
Inflation Rate

According to exchange rate theories a higher rate of inflation will make countries currency less attractive because of the loss of real value with inflation. Inflation level determines the value of currency. Higher the inflation, lesser will be the currency value.

South Korea's annual inflation rate was at 2.0 percent in November of 2018, unchanged from the previous month and below market expectations of 2.2 percent inflation reaching an all-time high of 32.50 percent in October of 1980 and a record low of 0.20 percent in February of 1999.

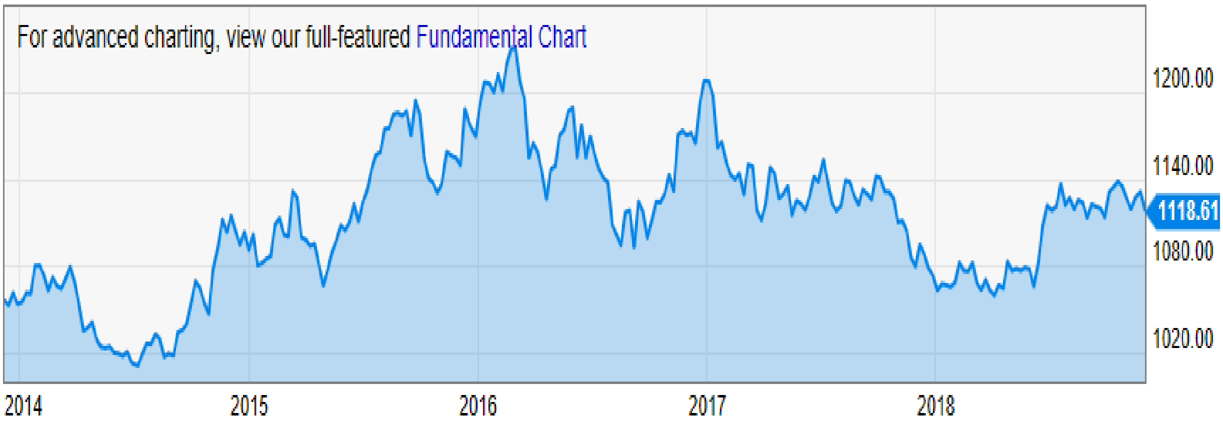
From the above data we can understand that from 2014-18 there is not much inflation in South Korea the highest was just above 2.5 which is not a very high rate and according to the theory, currency of a country should perform well in case of low inflation. Here being the lowest inflation rate, currency is performing against the theory of relation between inflation and value of currency.

2018 Currency value with respect to 1 USD



(Charts, 2018)

Last 5 years Currency value with respect to 1 USD



Above data shows a declining movement of value of currency of South Korea with respect to 1 USD. Currency value depicts a declining trend despite of all the above favorable conditions of trade. Considering trade surpluses over a period of 6 months, with high foreign exchange reserves and more than the standard amount of foreign exchange with respect to imports of the country, depicts a picture of currency manipulation by the country, South Korea.

Effect of Undervalued currency in South Korea:

- More exports from the country and thereby increased reserves in foreign currency
- Known for its rise from a poorest country to a developed high income country within a few generations
- Retention of trade partnership with the advanced nations
- Increased use of country's available resources, as the imports become more costlier and thereby developed a high technology boom and rapid economic growth
- Achieved higher rate of economic growth from 2008 onwards
- Exports become cheaper and more competitive to foreign buyers
- Higher exports and aggregate demand (AD) can lead to higher rates of economic growth.

Findings

Various countries use different methods for undervaluing the currency to achieve competitive advantage over the international trade. South Korea, by considering the determinants of currency manipulation of currency, can be considered that, the country is artificially devaluing the currency. Inflation, Trade surpluses, Imports of the country, foreign exchange reserves has a direct effect on the value determination of the currency. Undervalued currency has a competitive advantage over the international trade. South Korea focus more on the export from the country, hence devaluation can attract more buyers to the domestic market. Devaluation can also increases the production and consumption of goods and services within the nation as the imports are costlier, thereby higher growth rate of GDP can be ascertained.

Suggestions

US treasury works effectively to identify the currency manipulators among the trading partners. India should develop a specialized system to closely watch the trading partners and should avoid taking trade advantage by various trading partners. IMF and WTO should enact more on reducing the currency manipulation and closely watch the performance of nations within the global markets.

Conclusion

Currency manipulations by nations are becoming very common in today's world. Above determinants alone cannot give a 100% conclusion that, South Korea is a currency manipulator. However determinants state that, country can be categorized as highly potential currency manipulator. Detailed study on different variables should be conducted to have a clear idea on classification as a currency manipulator. Study gives us the inference that, there are nations who artificially devalue the currency to achieve competitive advantage over the trade practices.

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