Op-eds

Beijing Is Key to Creating More US Jobs

by C. Fred Bergsten, Peterson Institute for International Economics

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China has apparently decided to let its currency start rising again. There are two objectives. Domestically, a stronger renminbi will help counter inflationary pressure and dampen the excessive growth that is fueling it. Internationally, appreciation will start curbing China's huge current account surplus and thus counter the pressures that are building in the United States and elsewhere to retaliate against China's massive currency undervaluation by installing new barriers against its exports. The overriding issue is whether China will move quickly enough and substantially enough to achieve these goals.

The renminbi is now undervalued by about 25 percent on a trade-weighted basis and by about 40 percent against the US dollar. Every day, China buys about $1 billion in the currency markets, holding down the price of the renminbi and thus maintaining China's artificially strong competitive position. Several of China's neighbors—including Hong Kong, Malaysia, Singapore, and Taiwan—similarly intervene to remain competitive with China and thus substantially undervalue their currencies against the dollar and other currencies.

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Such currency manipulation is a blatant form of protectionism. It subsidizes all Chinese exports 25 to 40 percent. It places the equivalent of a 25- to 40-percent tariff on all Chinese imports, sharply discouraging purchases from other countries. It would thus be incorrect to characterize a policy response by the United States and other countries as "protectionist"—such actions should in fact be viewed as antiprotectionist.

Largely as a result of this competitive undervaluation, China's global current account surplus soared to almost $400 billion and exceeded 11 percent of its GDP in 2007, an unprecedented imbalance for a major trading country. This surplus declined sharply during the Great Recession as global demand weakened, but it remained above 5 percent of China's GDP even in 2009. The International Monetary Fund (IMF) estimates that the surplus is rising again and will hit record levels and exceed the US global deficit by 2014. In a world where subpar growth and high rates of joblessness are likely to remain for some time, China is exporting large doses of unemployment to the rest of the world—not just to the United States but also to Europe, Latin America, India, Mexico, and South Africa.

If China eliminated its currency misalignment and thus cut its global surplus to 3 to 4 percent of its GDP, that would reduce the US global current account deficit $100 billion to $150 billion. Every $1 billion of exports supports about 6,000 to 8,000 (mainly high-paying manufacturing) jobs in the United States. Hence, such a trade correction would generate an additional 600,000 to 1.2 million jobs. Correcting the Asian currency alignment is by far the most important component of US President Barack Obama's new National Export Initiative. Its budget cost is zero, which also makes it by far the most cost-effective possible step to reduce the unemployment rate and help speed economic recovery.

Such exchange-rate realignment is not without precedent. In 2005, Beijing announced a new "market-oriented" exchange-rate policy and let its currency appreciate 20 to 25 percent. In mid-2008, however, China repegged to the dollar, and the renminbi has ridden it down, taking back about half the previous rise. China has doubled the scale of its currency intervention since 2005, now spending $30 billion to $40 billion a month to prevent the renminbi from rising; on this metric, its currency policy is about one-half as "market oriented" as when it announced such a strategy five years ago.

This intervention violates all relevant international norms. The IMF commits member countries, including China, to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." Moreover, the IMF's bylaws call for "discussion" with any countries that practice "protracted large-scale intervention in one direction in exchange markets"—a succinct description of China's currency policy over the past seven years. Similarly, the General Agreement on Tariffs and Trade (GATT), which is now an integral part of the World Trade Organization (WTO), indicates that "contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement."

Huge current account imbalances, including the US deficit and the Chinese surplus, of course reflect a number of economic factors. Successful international adjustment requires corrective action by the United States and other countries, as well as by China. Effective adjustment policies must include much more than currency changes, notably including dramatic fiscal correction by the United States. But it is impossible for deficit countries to reduce their imbalances unless surplus countries reduce theirs simultaneously, and the restoration of equilibrium exchange rates is an essential element of an effective global "rebalancing strategy" as sought by the G-20 over the past year.

This is an excellent time for China to begin restoring an equilibrium exchange rate for the renminbi. The Chinese economy is booming (and China deserves great credit for leading the world recovery from the Great Recession). But inflation is rising and new bubbles are threatening, and the Chinese authorities have started to take measures to avoid overheating, including by shaving the growth rate. Currency appreciation would help by lowering the price of imports and dampening demand for exports. This would also promote a major structural policy goal, helping to rebalance the country's economic growth away from exports and toward domestic demand.

The case for a substantial increase in the renminbi's value is thus clear and overwhelming. Furthermore, it now appears that China is preparing to renew its gradual (5 to 7 percent per year) 2005–08 appreciations and/or announce a modest one-shot revaluation, with or without subsequent gradual appreciation. The most sensible approach for China would be an immediate rise of 8 to 10 percent with an indication that it would not move again until 2011, which would deter the accelerated capital inflows that could result from the one-way bet of a renewed upward crawl and indeed probably trigger a reflow that would ease the conduct of monetary policy.

It is not yet clear, however, whether China will move with sufficient speed and in sufficient magnitudes, over a period of three or four years, to eliminate its undervaluation and resolve the underlying problem. Hence the United States and other countries, while welcoming any meaningful new Chinese actions, must continue the "carrots and sticks" effort to both persuade China to revalue adequately and prepare retaliatory actions if it

does not. It is, of course, particularly important that any stepped-up initiatives toward China be multilateral. The Chinese are much more likely to respond positively to a multilateral coalition than bilateral pressure from the United States, especially if that coalition includes a number of emerging market and developing economies whose causes the Chinese frequently claim to champion.

Much of the blame for the failure of US policy in this area falls on Washington itself because it has been unwilling to face facts and label China a currency manipulator under the plain language of the Trade Act of 1988. This has substantially undermined US credibility in seeking multilateral action against China in the IMF, the WTO, the G-20, or anywhere else. If China continues to intervene heavily in the currency markets and manages the renewed rise in a very restrictive manner, say by less than 8 to 10 percent per year, a sensible and effective strategy must begin by reversing that feckless position with deeds rather than just words. In that situation, the Obama administration could adopt a three-part strategy to promote faster and more substantial appreciation of the renminbi's exchange rate.

First, the Treasury Department should brand China a "currency manipulator" in its next foreign exchange report to Congress—the report now delayed from April 15, or in October of this year at the latest—and, as required by law, then enter into negotiations with China on the currency problem.

Second—with the support of Europe and as many emerging-market and developing economies as possible—the United States should seek a decision by the IMF to launch a "special" or "ad hoc" consultation to pursue Chinese agreement to remedy the currency situation. If such a consultation fails to produce results, the United States should ask the IMF Executive Board to publish a report criticizing China's exchange-rate policy.

Third, with a broad coalition, the United States should exercise its right to ask the WTO to constitute a dispute settlement panel to determine whether China has violated its obligations to that institution and to recommend remedial action. The WTO under its rules would ask the IMF whether the renminbi was undervalued, another reason why it is essential to engage the IMF from the outset.

This three-pronged initiative would focus global attention on the continuing misalignment and China's unwillingness to initiate adequate corrective action. The effort would have maximum impact if the United States undertook it with countries constituting a substantial share of the world economy, including emerging market and developing economies as well as the Europeans and other high-income countries. Asian countries, such as Japan and India, will be skittish in confronting China in this way, but they are hit hard by the Chinese undervaluation and should be increasingly willing to join the coalition as its size grows.

The objective of the exercise is of course to persuade, or "name and shame," China into corrective action. Unfortunately, the IMF has no sanctions that it can use against recalcitrant countries. Hence the WTO—which *can* implement sanctions—needs to be brought into the picture. Unfortunately, there are technical and legal problems with the WTO rules too (like the IMF rules), so they might also need to be amended for these purposes in the future.

The United States could of course intensify its initiative by also taking unilateral trade actions against China. For example, the administration could decide that the renminbi's undervaluation constitutes an export subsidy that would be considered in decisions to apply countervailing duties against imports from China. Congress could amend current laws to make clear that such a maneuver is legal. In either case, China could appeal to the WTO, and the United States would have to defend its actions under the Subsidy Code.

But product- or sector-specific steps, such as last year's tire tariff, are undesirable because they distort and disguise the across-the-board nature of the Chinese currency misalignment. China's competitive undervaluation represents a subsidy to *all* exports and a tariff on *all* imports—not just a few. It requires a comprehensive response via the exchange rate itself. A US-led global effort offers the best chance to convince

China to let its currency rise sufficiently and to help both itself and other countries achieve sustained economic recovery.

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Washington, DC 20036. Tel: 202-328-9000 Fax: 202-659-3225 / 202-328-5432
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