China's Declining Current Account Surplus, Part III

Arvind Subramanian says that despite an improved current account balance, China should still be pressed to let its currency appreciate further.


Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics in another in a series of conversations about the Chinese currency undervaluation -- this time, with Arvind Subramanian. Arvind, the trend suggests that China's currency has appreciated; its current account surplus is down. Is that grounds for complacency or optimism about this problem?

Arvind Subramanian: It certainly changes the urgency for action and the case that outsiders make for China to change, but I don't think it fundamentally lets China off the hook for its currency policy for two reasons.

One, I think, is that if you look at the Chinese exchange rate from a kind of broader productivity perspective, it's still substantially undervalued. It's been growing for the last 30 years at about a 10 percent or 8.5 percent productivity relative to the rest of the world, but the Chinese currency hasn't appreciated to keep up with that.

So, in the fundamental long run sense, it remains substantially undervalued and we have numbers to show that.

Steve Weisman: This gets to the complex issue of purchasing power parity. Is that related to the productivity issue you just outlined?

Arvind Subramanian: Yes, it's central to the productivity issue from a macro perspective. But if you look at it from the growth perspective, the fact is that the Chinese economy has become so much more competitive because of productivity changes. But its exchange rate hasn't kept up in line, so that's the first one.

But I think the second reason that China is not off the hook is -- what has the Chinese exchange rate done for other developing countries and countries that compete with China?

Steve Weisman: It's hurt them.

Arvind Subramanian: It's hurt them substantially. In fact, my colleagues Aaditya Mattoo, Prachi Mishra, and I have a very rigorous research paper that's come out which shows that the effect on other developing countries of China's policy can be substantially adverse.

Steve Weisman: The policy implications for the United States from these developments are what?

Arvind Subramanian: It's actually interesting, Steve, that even as we speak, the WTO [World Trade Organization] is debating what it should do on exchange rates. It fits in with your
question. I think what the United States should do—as I’ve been saying for a long
time—is to have a more multilateral rules-based approach to solve the exchange rate
issues—i.e., forge a coalition of not just other industrial countries, other developing
countries, emerging market countries to raise this as a problem on which we need new
multilateral trade rules.

Steve Weisman: But these other countries have been reluctant to join such a coalition?

Arvind Subramanian: They are. But I think as I’ve always said, the longer this currency policy persists, the
more other countries are affected. And you see now, there may be less kind of pressure
from the U.S. side because of these current account deficit developments. But for these
other countries, I don't think that situation has changed very substantially because of
the productivity stuff that we spoke about.

Steve Weisman: Thanks, Arvind.

Arvind Subramanian: Thanks, Steve.