



Is China a Currency “Manipulator”?

Morris Goldstein says Treasury Secretary Geithner was correct to label China a currency manipulator but argues for a nuanced approach in addressing the problem.

Recorded January 28, 2009. © Peterson Institute for International Economics.

Steve Weisman: Welcome to Peterson Perspectives. This is Steve Weisman at the Peterson Institute for International Economics. It’s a pleasure to welcome back Morris Goldstein, senior fellow at the Institute and coauthor with Nicholas Lardy of a forthcoming book *China’s Exchange Rate Policy: Options and Prescriptions*. And there could not be a more relevant topic for our discussion today. Welcome, Morris.

Morris Goldstein: Glad to be here.

Steve Weisman: Treasury Secretary Geithner has taken office following some very interesting testimony in which he said that China was a currency manipulator or had engaged in currency manipulation. What was he referring to?

Morris Goldstein: I think he was referring to China’s efforts to use prolonged large scale exchange market intervention to keep the value of the renminbi from its right level, its market-determined level. That’s what he was referring to.

Steve Weisman: Why would China be doing that?

Morris Goldstein: I think they’ve done it for employment and social stability reasons. This obviously has created somewhat of a controversy, but I think what’s been lost in the reporting of late is that what Secretary Geithner said was true. Since 2004 China has been engaging in currency manipulation. And the issue is, well, why should we be concerned about that? I think there are a number of reasons to be concerned.

Steve Weisman: They’ve been manipulating in order to keep the value of the currency artificially low, is that right?

Morris Goldstein: That’s right, so they would be more competitive. That really runs against the IMF rules of the game about what you can do on exchange rate policy. The difficulty is, if you don’t say so, if you don’t lay out bad behavior for what it is, then you really have no international surveillance of exchange rate policies. You have no rules of the road in a sense.

And that's problematic on a number of grounds. First of all, it fans protectionist pressures. You can't really get a country to say, "Well I'm going to keep my markets open if I feel that the people I compete with are not playing by the rules of the game. They're getting a subsidy for their products and we're not." And it becomes difficult then to keep markets open when you have this kind of behavior. It's especially difficult now when we're in a global recession. When unemployment is going up everywhere, people are more sensitive to it. Second, if you allow that, if you don't tell it like it is, then when you get that, it encourages countries to say, "Well, the world is a risky place. What I need to do is build myself a large war chest of international reserves that I can use as insurance for all of kinds of things. And the way for me to get larger reserves is to have a very undervalued currency." Then once they have a lot of reserves, there's a question where they're going to invest it. If they don't have adequate opportunities at home, then it goes abroad, you get lower interest rates, and it leads to a financial climate where you can get the kind of excesses that we've seen in the United States in the run-up to this crisis. And I'm not saying that's the major cause of this crisis, but it's a contributing factor.

So in short, you don't want to have a situation where you can get away with currency manipulation. Yes, it's embarrassing to say so, but it's better to tell it like it is.

Steve Weisman: The Bush administration and the IMF fell short of labeling China a manipulator, isn't that right?

Morris Goldstein: That's right. The Bush administration said, well, they couldn't do so because they couldn't prove intent. But it's pretty clear what's been going on and you don't really need to prove intent. You have the facts.

More distressing I think is that the IMF—which really is the agency set up to police this system—has been really absent without leave. I mean, they've been asleep at the switch. They took a very long time to even say the renminbi was undervalued. Once they said it was undervalued, they couldn't say how much it was undervalued. Then they said they couldn't say it was manipulated—they had to have some new guidelines. But once they got the new guidelines and were supposed to say it was fundamentally misaligned, they couldn't say that because we're starting in a crisis, a bad time. And we had the Olympics—that was a bad time. So the results were that there never was a good time for them to say so, and they haven't said anything. And that's really unfortunate because this, as I suggested earlier, is part of the process by which we keep markets open.

Steve Weisman: But they didn't want to anger the Chinese. It was a strategy of

accommodating them. Steve Weisman But you're saying that didn't work?

Morris Goldstein: Well, it doesn't work, and somebody has to bell the cat. And in this case, the IMF is the agency responsible for enforcing those rules. And if you don't have enforcement, then the rules, whatever they say on paper, don't mean anything.

Steve Weisman: What do you say to those who, like Treasury Secretary Paulson, might argue that a conciliatory approach and no name-calling actually gets China to move better and that indeed China's currency has appreciated recently?

Morris Goldstein: We certainly should draw a distinction between what happened from 2004 through near the end of 2007 and what's happened over the past 15 months. This is an important distinction that you're drawing. If you go back to, let's say, October 2007, it really was the perfect time to be calling China on the carpet for its exchange rate policy for a number of reasons.

Their global current account surplus has been steadily going up since 2001. It was 1 percent of GDP then. In 2007, it was essentially 11 percent. So it has gone up to a huge number. By 2008, they had done very little in moving the real trade-weighted exchange rate of the renminbi. It had only gone up since their currency reform by 7 percent. It was undervalued by perhaps 40 percent so they only did seven percent. In the meantime, the domestic economy in China was booming. In 2007, it grew by over 13 percent and an appreciation of the renminbi would have helped them to cut down that overheating. So both for international reasons, for domestic reasons, they hadn't done it. They had been intervening to the tune of 10 percent of GDP for a very long time to keep market forces from rising.

Now, since then, they've made considerable progress. By now, the real trade-weighted value of the renminbi since the currency reform, since just before that, has gone up over 20 percent, which is not trivial. So they're probably on the order of halfway to where they need to be.

Also, the economy in China slowed down. In the last quarter of 2008, it grew by 6.8 percent. And no doubt, that's the fifth consecutive quarter in which growth has declined. And when you have the economy booming, it's what we call a nondilemma situation for exchange rate policy. You revalue the currency. It's good for what you need on domestic grounds, it's good on external grounds. But now that the economy slowed down, you have a dilemma. If you revalue the currency a lot, it helps reduce the external surplus, but it slows the economy down when you're trying not to do that. And the answer to that is you have to use expansionary fiscal policy to offset the contractionary effect of the revaluation. If you combine that with a revaluation, you can do so.

But the bottom line is we should still be asking them to make further progress since they have a ways to go. But we can do it slower now; they don't have to move quite as fast. They can get a couple percent of appreciation a year until they get out of the slowdown. Then we can do a little more later. So there has been a distinction. But certainly for a very long time, the "don't say anything" approach didn't produce anything.

Steve Weisman: Now that Secretary Geithner did use the word, what is the likelihood that the Treasury Department in its first report to Congress on exchange rates policies this April will use the word in that report? And if it does, what happens then?

Morris Goldstein: Well, I think we have a somewhat more nuanced situation than we had a year ago or so. I think they should say, to set the record straight, that China had been manipulating in the past and still is doing so, but they were manipulating particularly from 2004 through 2007, 2008. They're still doing it in the sense of large scale intervention to keep the renminbi from rising as much as it should. And that such currency manipulation is against the IMF rules of the game and it's undesirable. The report should say that. The report should also acknowledge that in the last 15 months or so, they've made a lot more progress in allowing the rate to move. Their global current account surplus is peaked. It's probably starting to decline. So I think they should be encouraged to cut down on the scale of intervention, but I wouldn't recommend punitive penalties right now.

Steve Weisman: The law calls for penalties, doesn't it?

Morris Goldstein: Well, it first calls for consultations and later you can do other things, but I think it's important to tell the truth. And the truth is they have been manipulating and they need to stop that and reduce the scale of their exchange market intervention. I would give them a little more time to see that they maintain the progress they've made recently, to see that they don't backtrack and try and push the exchange rate in the wrong direction. That would be very serious.

But they don't have to move the exchange rate quite—appreciate as fast as they have been—because they're in a slowdown and they've already done something significant. So the report has to be a little more nuanced—talk about what they haven't done right, but talk about what they have—and that I think would be an improvement.

Steve Weisman: Do you expect that Treasury will play the lead role with China as it did in the Bush administration, or will they have a much more broad agency-wide approach?

Morris Goldstein: I think it's not clear yet. They certainly had to lead when Hank Paulson was the Treasury secretary through the Strategic Economic Dialogue. It may be the case now that some other agency does that, but I think Treasury will still be the lead economic agency and their view will be very important in our whole economic relationship with China.

So I think what's important is that we get the right message out, if some other agency takes the lead, say the State Department. I'm not so worried unless that would mean that they go soft completely on the exchange rate issue. That would be very unfortunate because I think keeping up some pressure on China to do the right thing on the exchange rate will be in everybody's interest, including the Chinese.

Steve Weisman: How do you assess the Chinese reaction so far to the administration's first statements and moves?

Morris Goldstein: I think the Chinese reaction has been restraint. We don't know whether it's been restraint because President Obama called President Hu and told him not to misread the press statements and the like about the currency. But I think it's helpful to try and have a collaborative approach.

But there are other areas where we don't hesitate to criticize China, whether it's trade policy or human rights, and I see no reason on the exchange rate not to also tell it like it is, but still make it clear to them that we want a collaborative relationship, and sometimes we'll criticize them, sometimes they'll criticize us but we have a common interest in moving forward together.

Steve Weisman: Thank you, Morris. We'll look forward to your further comments and to the book, *China's Exchange Rate Policy: Options and Prescriptions* with your coauthor Nicholas Lardy, who is also a senior fellow here.

