



## China vs. the Rest of the World?

*Arvind Subramanian argues that exporting countries in Asia, Africa, and Latin America have more reason than the United States to oppose China's artificially undervalued currency.*

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Steve Weisman: China is increasingly seen and criticized in the United States for its currency policies. This is Steve Weisman at the Peterson Institute for International Economics with Arvind Subramanian, senior fellow at the Institute, who argues that the Washington perspective is too narrow and there may be a better way to pressure China. Arvind, thanks for joining us.

Arvind Subramanian: Thanks, Steve, for having me.

Steve Weisman: Arvind, you have a piece in today's *Financial Times* arguing that the focus on China should be more broad gauged around the world. Tell me what you have in mind on that.

Arvind Subramanian: Well Steve, for too long the Chinese exchange rate has been viewed through the prism of global imbalances. That is when we talk about the crisis, people say, "Well, it was caused by global imbalances," which is another word for saying that some countries like China ran big current account surpluses, i.e., they exported more than they imported while other countries like the United States did the opposite. So the argument goes that because China ran these huge global imbalances, it flushed the international system with cheap money and that cheap money was kind of really used by consumers in the United States to indulge in this profligate borrowing, which led to housing bubbles, etc.

Now as soon as you say that China caused the global imbalance problem and hence the financial crisis, China comes back and says, "Why do you blame us? What about other countries that ran huge current account surpluses like the oil exporters or Japan?" And in any case, finally, you can't blame the bartender for plying the customer with alcohol. Finally, it's the customer who goes on a drinking binge. So it allows China to muddy the intellectual waters first, but more importantly, it obscures who the real victims of China's exchange rate policy are. And who are these victims? China's exchange rate policy is really mercantilist trade policy. It has a currency policy that makes imports very difficult to come into China and it has a policy that subsidizes exports. That's what the exchange rate policy does. Now, if it does that, who are the victims of that? Those countries that compete with China in trade terms. And who are those countries? Other emerging market and developing countries and not the United States and the European Union.

So in some ways, the whole global imbalance perspective has distorted our assessment of who is hit most by China's exchange rate policy and that's why I think we need to

refocus and say, “Look, there are lots of other countries that are very, very affected and we need a broader coalition of all these emerging market and developing countries along with the United States and the European Union to come together and say, ‘China, you know, you’re a big country, you’re an important trader, you have international responsibilities and so it’s time to change your exchange rate policies.’”

Steve Weisman: Fred Bergsten, director of the Institute here, and other economists like Paul Krugman argue that China’s undervalued currency has produced unemployment in the United States. You’re not disputing that, you’re just saying that that’s too narrow a focus to get something done, is that right?

Arvind Subramanian: Correct. I think I’m saying two things, Steve. One, I think it’s a somewhat narrow focus and it needs to be broadened, but I think I’m also making a slightly stronger analytical point that if a country follows a mercantilist protection as trade policy, the countries or the people who are most affected are those that compete with that trading partner rather than countries like the United States, which actually buys a lot from China. So in some ways, I’m making the stronger claim that even if the United States, say, loses 1.4 million in employment, there are countries that compete with China more directly that probably stand to lose a lot more.

Steve Weisman: What evidence do you see that the United States is going to put together a coalition of the countries that compete with China, such as India or Brazil or their countries in the Latin America, other countries in Asia?

Arvind Subramanian: That’s a really good and a difficult question because the problem is that although many of these emerging market and developing countries are affected around the world, they don’t speak up. Now why don’t they speak up? In the case of Africa, it’s because China also provides a lot of foreign aid and direct investment. In the case of East Asia, the problem is that many of these countries are integrated with Chinese production chains. So they have a kind of mixed interest in relation to China. So, really the countries that can speak up are countries like Mexico, Brazil, Turkey, South Korea, maybe India, South Africa. So they need to come together with the United States.

Now, is this going to happen? I think there is a little more hope that this will happen because at the moment, Steve, there’s something interesting going on. It’s not just that trade of these countries is being affected—it’s also that macropolicy management in these countries is being affected because central banks see all this capital coming into their own countries and they can’t let their currencies appreciate because that of a major competitor, namely China, is actually maintaining a weak currency. So, I’m hoping now that central bankers in these emerging market countries along with the trading constituency can come together with the United States.

So what it’s going to need? It’s going to need a more creative diplomacy on the part of the United States to reach out to these countries and it needs a certain, I would say, boldness on the part of emerging market countries to respond to this overture from the United States. But I think that needs to be explored instead of the United States doing this issue completely bilaterally by, say, naming China a currency manipulator and so on, because that direct action against China is not something that a proud and prickly nation like China will easily respond to.

Steve Weisman: Final question: Is there a role for the WTO or the IMF in this?

Arvind Subramanian: I think, Steve, the IMF has tried and comprehensively failed. Now, even the IMF managing director has often said that the Chinese currency is undervalued but I think China just brushes it off. So I think if at all there is a possibility for multilateral resolution, it will have to be through the WTO. At some point, countries have to get together and say, "Undervalued exchange rates are mercantilist trade policy. Can the WTO adjudicate on this?" That I think is the most promising avenue. Whether it'll succeed remains to be seen.

Steve Weisman: Arvind Subramanian, thanks a lot for joining us.

Arvind Subramanian: Thank you, Steve.

