



China: Dealing with an Insecure Juggernaut

Arvind Subramanian argues that US unilateral actions over China's currency could backfire and that a multilateral approach through the IMF or WTO would be more effective.

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Steve Weisman: China is stirring up a furor over its currency policies and other practices, including its relationship with Google. This is Steve Weisman at the Peterson Institute for International Economics with Arvind Subramanian, senior fellow at the Institute, to talk about whether there's a danger in the world trying to isolate China. Thank you, Arvind.

Arvind Subramanian: Thanks, Steve.

Steve Weisman: Is there a danger that China is going to feel surrounded by critics and that this might backfire?

Arvind Subramanian: I think, Steve, there is a danger because what is happening now is that I think the United States is flexing its unilateral muscle a bit too much for my comfort. This is not to say that a Chinese exchange rate policy is not a problem and needs to be addressed and changed within a short space of time. But the key question for everyone is whether there should be a broader multilateral effort, or whether the United States should take a lead and charge on ahead on its own, leading to a confrontation with China that could turn a bit sour—even ugly.

Steve Weisman: China is well known to have undervalued its currency, the renminbi, in relation especially to the dollar, and the Obama administration is pondering what to do about that. And there are reports that they might reverse years of policy and label China as a “manipulator” of its currency levels as early as next month—April. Is that the sort of thing that you're talking about?

Arvind Subramanian: Yes, exactly. I think a couple of things are happening. One is by mid-April, as you said, the US Treasury will have to pronounce publicly on whether China is a currency manipulator. And recall, in Tim Geithner's testimony when he was coming in as US Treasury secretary, he used some such word and remember what a furor it kicked up. It is a very sensitive issue and China will not take kindly to being branded as a currency manipulator. So that's on the executive side.

I think meanwhile on the legislative side, there has been once again a revival of legislative initiatives like we saw some years ago, Schumer-Graham [Senators Charles Schumer and Lindsey Graham] aimed at beginning to impose kind of unilateral tariffs against China. But the big event is going to be whether in mid-April China is going to be branded a currency manipulator by the US Treasury.

Steve Weisman: Treasury has passed up the opportunity once or twice already to do this. There are indications that it might be changing its mind. If it's a bad idea, what are the alternatives?

Arvind Subramanian: First I think it's a bad idea. The irony is that there were opportunities that the US Treasury passed up in the past, when China's actions were in some way much more

egregious. At the moment, the current account deficit has come down quite sharply. It was about 11 percent [of GDP]. Now it's down to about 5 percent this year. And during the crisis, people forget China has been a very good global citizen, injecting demand by enacting its huge fiscal stimulus policy.

So, it's not that China's exchange rate per se doesn't need remedying. But it seems like the wrong time because when the actions were much worse, we passed up [a chance to act] and when the actions are not so bad, or at least the outcomes are not so bad, we are suddenly turning unilateral.

Steve Weisman: Don't you think that if it keeps on the current track, China's exports and its current account surplus are going to go back up to the historic levels?

Arvind Subramanian: Yes. I think the forecast is that it's likely to rise again. But I think in trade matters and all these matters, we have to act when things actually happen rather than preemptively striking. If we were to act now, it would be kind of the Bush-Cheney doctrine of preemptive strike, which seems a little bit excessive at this stage. So what are the alternatives? That was your question.

Steve Weisman: Right. What are the alternatives?

Arvind Subramanian: I think there are two multilateral alternatives. One is through the IMF [International Monetary Fund] and one is through the WTO [World Trade Organization]. Now, the IMF alternative is to put much more pressure on the IMF to, in turn, put pressure on China. For example, the managing director [Dominique Strauss-Kahn] could go off to China and have a special consultation on the Chinese exchange rate with the view to coming back and saying, "We've had this consultation. We've made progress and China has agreed that it's going to act on its policy."

Whether that's going to work or not remains to be seen. In the past, as I wrote in the Financial Times, the IMF has been almost shouting everyday that the Chinese currency is substantially undervalued. And as I said in my piece, this is like water off the Beijing duck's back. The IMF is toothless on this.

That's why we need a slightly more muscular, multilateral approach. I'm against muscular unilateralism, toothless multilateralism won't work, so the intermediate stage is muscular multilateralism and that's the WTO. In the WTO there is leverage; there are better enforcement mechanisms.

Steve Weisman: Correct me if I'm wrong, but hasn't the WTO stayed away from the currency area as a matter of doctrine?

Arvind Subramanian: Okay. That's a good question. I think there are two or three ways of looking at it. First, it is not right to say that the WTO has nothing to say on exchanges. There is a provision in the GATT [General Agreement on Tariffs and Trade], Article 15-4, which says that countries shall not by exchange action frustrate the intended provisions of the agreement. So, in some ways, there is the spirit of saying that undervalued exchange rates are really an extreme form of trade protectionism. At least there's something there in the spirit of the law that could be used to remedy situations of undervalued exchange rate.

But clearly, all the experts say that the letter of the law does not permit any effective enforcement. If, for example, the United States were to take China to the WTO [with] a dispute, it's almost certainly the case that the United States would lose. So that's why my suggestion is—what Aaditya Mattoo of the World Bank and I have proposed is: why not start a cooperative rulemaking process involving China but also involving all those other countries who have a big stake in the Chinese exchange rate? Because they too are being affected. As I keep saying, many of these countries, because they compete with China, are in some ways more affected than the United States itself.

So I envision a process where everyone gets together and says, "Look, clearly this is a systemic issue, it's not an isolated instance. It's something that could have an impact down the road. Let's have new rules that make sense." And one of those new rules would be to say if exchange rates are substantially undervalued, manipulated, misaligned, then partner countries should be allowed to take trade action. So that would be the kind of approach I would favor.

Steve Weisman: The West of course sees China as this big economic juggernaut. But I'm wondering if its exchange rate policies and what it's doing on Google doesn't reflect a certain insecurity in the leadership in Beijing. They don't feel strongly enough about the stability of their country to tolerate this sort of dissent that would be spread under the auspices of Google. And secondly, they must have a heavily export-driven [economy] to employ people and keep them satisfied under what still is a totalitarian regime.

Arvind Subramanian: I mean the answer is obviously both. On the one hand, China is this absolute economic powerhouse, and it's demonstrated that in the last 10 years, which is pushing ahead, making rapid strides across the board, not just in terms of growth but in terms of technology, for example. The whole Google thing is part of a larger effort to attain frontier technological prowess, and that's the way I read Google because they're trying to develop local search engines and that kind of thing.

So it's a juggernaut. It's powering ahead very successfully, but there is a sense in which there is something tenuous about this process, which you alluded to—that this is a regime obviously that is not democratic, not transparent completely, and therefore has the innate insecurity that unless it delivers on say, economic progress, it will feel vulnerable in all these other political fronts.

To be fair to the [Chinese] authorities, any kind of change that involves social disruption is politically not very easy to deal with. All countries have this problem. But perhaps in the case of China, it's a bit more heightened because it's in an inherently, slightly vulnerable situation because it's not an open democratic system.

That's where I think the contrast with India is very interesting. Yes, lots of political cost, lots of populism, but the point is that the regime isn't under the gun, as it were, all the time. I mean the worst that can happen to you is you lose an election, you get thrown out of power but then you're still part of the political process. But perhaps in the case of China, that inherent vulnerability is kind of showing up now, and that explains the authorities' reluctance to move, even on the exchange rate, because of the possible social and political disruption.

Steve Weisman: Arvind, thanks very much.

Arvind Subramanian: Thanks, Steve.

