Flawed Strategies Against China

Michael Mussa assesses the various proposals to persuade or prod China to let its currency appreciate—and finds that all of them come with drawbacks.

Steve Weisman: The world is filled with ideas on how to persuade China to let its currency appreciate, some from here at the Peterson Institute for International Economics and some from other scholars and experts. This is Steve Weisman at the Institute to talk with Michael Mussa, senior fellow, about some of these proposals and the chances for any of them either being implemented or accomplishing their goal. Thanks, Mike.

Michael Mussa: My pleasure.

Steve Weisman: First, how intractable and serious is China's currency as a problem facing the global economic community?

Michael Mussa: The problem really dates to 2001–02 when they began this policy of resisting very strongly the appreciation of the renminbi through large-scale official intervention. They'd done some of that before, but it did not become a serious problem until about a decade ago.

Steve Weisman: What's so bad about suppressing the value of the renminbi?

Michael Mussa: It depends on how severe those efforts become. But the international economic system is supposed to be able to adjust over time to limit the extent of international payments imbalances. When a country intervenes extensively and persistently in the foreign exchange market, it frustrates the international adjustment process. Actually, that problem is now much more severe than it was five or six years ago because we now have substantial amounts of unemployment—"margins of slack," we like to say as economists—in the United States and other industrial countries, which was not the case in 2005–06. And the Chinese policy is making it more difficult to secure a more rapid recovery and reduction in those margins of slack.

Steve Weisman: Congress is frustrated, the Obama administration is frustrated—

Michael Mussa: There's a positive side to everything.

Steve Weisman: What ideas for tackling this do you take seriously?

Michael Mussa: Of course, the United States has had ongoing conversations with the Chinese going back six or seven years with various treasury secretaries leading those efforts. I think it's fair to say that they've not yielded very much in the way of adjustment by the Chinese. The Chinese did announce earlier this year that they were going to, once again, resume allowing the renminbi to appreciate. But so far the appreciation against the dollar has been quite modest and actually their currency on a weighted average basis against all trading partners has depreciated as the dollar has come down against the euro and the yen.

Steve Weisman: Let's talk about a proposal discussed here from our director, Dr. C. Fred Bergsten. But addresses it in a general way which is what the United States should do. If the Chinese purchase dollars, somehow we should retaliate by purchasing renminbi to keep the exchange rate stable. Do I understand that correctly?

Michael Mussa: That's certainly Fred's proposal of sort of countervailing intervention. I must say it's not clear to me that it would accomplish much in a positive direction. If we're going to buy something, I would think we'd want to buy US goods or US assets to stimulate our economy rather than buy Chinese assets.

Steve Weisman: What about putting on countervailing trade barriers, an idea circulated in Congress?

Michael Mussa: The House of Representatives passed a bill that would enable the Commerce Department to use, in its calculation of countervailing duties in subsidy cases, an estimate of the extent of undervaluation. That's a quite modest action because you first need to find that there is a subsidy on a specific product and then establish if the countervailing duty on that product is appropriate. The amount of Chinese exports that might be hit by this would probably be only a few billion. So it's mainly a signal that the United States is becoming increasingly concerned. It is by no means clear that it will become law, that the Senate will pass it before the end of the present Congress. The Obama administration has not indicated either support or opposition at this stage.

Steve Weisman: In the Senate, there's legislation that would impose across-the-board tariffs if the currency is not adjusted.

Michael Mussa: It is not clear whether Senator [Charles] Schumer is going to try and push it at this stage, to try and get something through late in the session. The earlier Schumer-Graham Bill involved the 27.5 percent tariff across the board on all Chinese exports to the United States. That would be a very major measure because we're talking about $300 billion, roughly, of Chinese exports to the United States each year. So, a 27.5 tariff on that magnitude of trade would be a very substantial action. Illegal under the WTO as well.

Steve Weisman: Regarding Dr. Bergsten's proposal, you said it would be better to buy US assets. Martin Wolf had a column recently in the Financial Times suggesting that doing that by the Federal government or by the Fed might also affect the currency. You don't think that's necessarily a healthy way to go.

Michael Mussa: I think there's an issue of whether the Fed should, at this stage, engage in what they call additional quantitative easing, which means buying longer-term treasury securities—four or five years, perhaps as long as 10 years—in substantial amounts, say half a trillion dollars or something like that, in an effort to boost the size of the Fed's balance sheet, cut interest rates more generally and boost the US economy. Doing that, of course, makes more dollars available in general and tends to depress the foreign exchange value of the dollar. So that achieves some of the effect of adjusting the exchange rate. But it adjusts the exchange rate primarily against Europe and Japan and the rest of the world and not against China.

Steve Weisman: Why?

Michael Mussa: Because the Chinese are pegging their rate, more or less, [to the dollar].

Steve Weisman: So they'll just buy more dollars?

Michael Mussa: Yes, and we can print more and more and more. I mean, sometimes there's not really much of an effective limit if the Chinese want to buy an enormous amount. We can always make that available to them. I sometimes say that we should tell the Chinese: "Yes, we want you to buy our currency and our bonds, but we insist that you commit that, for at least the next 50 years, you will buy $500 billion a year and not sell anything." And if the Chinese were compelled to do that, I think they would have second thoughts about what they're doing.

Steve Weisman: So we've talked about the impracticality of some of these countervailing currency or asset purchases, countervailing trade barriers, quantitative easing. What about another proposal that's been circulating that would bar the Chinese from buying US government assets, unless China allows the United States to buy Chinese assets? Tell me what you think of that idea?

Michael Mussa: The Chinese do not have an extensive domestic marketable public debt. So even if they let us into their market, to the extent that it exists, there wouldn't be all that much we could buy, even if we had the money to buy it with. And if we have the money to buy it with, there is the question of why we want to buy [Chinese assets] rather than US assets. One could argue that in order to restrict Chinese intervention, we could deny them access to purchasing US government bonds or purchasing additional US government bonds.

Steve Weisman: Would that be a good idea?

Michael Mussa: I think not. We have a very large federal deficit, and we're interested in financing it at as low a cost as feasible. If we were to impose that type of restriction on the Chinese, even if not imposed on other countries, people would become increasingly nervous about the possibility of that type of intervention by the US government. This would make, at least potentially, our debt less marketable than it has been. And we've maintained, for many years, a policy of open participation—

Steve Weisman: And marketable at greater cost, meaning higher interest rates, which is not what we want now.

Michael Mussa: Not at this moment. I, for one, don't exclude trade action. When President Nixon wanted to motivate a change in the exchange rate of the dollar, which had become very rigid under the old Bretton Woods System, in his shock measures of August 15, 1971, one of the things he did was to slap on a 15 percent across-the-board import tariff on everybody. And that was quite illegal under the WTO, but Nixon was sending a message.

Steve Weisman: Of course the WTO didn't exist. It was the GATT [General Agreement on Tariffs and Trade].

Michael Mussa: The GATT at that time, yes. But, I would resort to that measure only in extreme circumstances. That is kind of a nuclear option. I don't think we've reached that point yet.

Steve Weisman: So what do we do?

Michael Mussa: I think we keep talking to the Chinese and keep putting pressure on them. Other countries have begun to speak up more about this issue. They've also expressed concern about the depreciation of the dollar under our policy of easing monetary policy, and we need to be sensitive, I think, to that concern. I've long argued that the Chinese policy is not, in fact, in China's interest. They've got $2.5 trillion of foreign exchange reserves. They don't need any more. It's not the best thing they could do with their money, and they've become too beholden to the export interests in China and too fearful that even a modest appreciation of the renminbi is going to seriously impair the growth of their economy. Sure, if they appreciated 25 or 30 percent in a period of a year or so, that would be a real problem of adjustment for the Chinese export-oriented industries. But they can appreciate 5 percent a year, 6 percent a year and the effect will be quite modest.

Steve Weisman: The effect on their economy? The effect on the trade balance and current account balance?

Michael Mussa: All of the above. What we, I think, need from China now in terms of the strategy to sustain global growth is not that their current account surplus shrink but that it not expand.

Steve Weisman: It has shrunk.

Michael Mussa: It did shrink from the level it reached in 2007 and 2008 along with the collapse of world trade. It went from about 10 percent of China's GDP down to 5 percent. But it is now growing again. What we would like to see is that it not grow more. Chinese exports can continue to grow, but no more rapidly than Chinese imports, both of which would be growing probably 15 percent per year given the growth rate of the Chinese economy. Trade tends to grow more rapidly than GDP. But, what we want to see is not a contraction of Chinese exports or net exports but simply that exports not grow more rapidly than imports at this time, so that China is not subtracting growth from the rest of the world at this critical stage.

Steve Weisman: A month or so away from the meetings of the next summit in South Korea, what are the chances of the world using sweet reason and persuasion to get China to change its approach?

Michael Mussa: I think better than persuading the Iranians to give up their nuclear ambitions, but maybe not a lot better.

Steve Weisman: Mike Mussa, thanks very much.