China's Declining Current Account Surplus, Part V

Joseph E. Gagnon says that while China has improved its record on currency, other countries have adopted the same unwelcome policies.

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Steve Weisman: Joseph Gagnon, senior fellow at the Peterson Institute for International Economics is here with me, Steve Weisman, in another conversation about the appreciation of the Chinese currency and also the decline, however temporary, in China's current account surplus. Joe, first of all, the trend has been in the right direction. Explain.

Joseph Gagnon: China's current account surplus, which is basically a broad measure of their trade surplus, has come down. It's below three percent of their GDP last year and the first quarter this year seems on track to probably roughly repeat that this year. That's a big improvement. Maybe not 100 percent of where we want to be, but a big improvement from almost ten percent a few years ago. They've allowed their currency, the renminbi, to appreciate at roughly 30 percent over the past seven or eight years, so that probably had a big role in this improvement. But another thing that is probably temporary is just that the U.S., Europe, Japan, their big customers for Chinese exports, have been very weak. Our economies have been very weak and there is a question as to how much China's trade surplus would jump up again if the U.S., Europe, and Japan had a strong recovery.

Steve Weisman: I think the suggestion is that it almost inevitably will.

Joseph Gagnon: Yes. It's a question of how much. How much of this improvement is because the renminbi has appreciated and how much of it is because the U.S. and Europe is weak? The latter is temporary; the former is permanent.

Steve Weisman: So China has improved. It has a ways to go. They should still be subjected to some scrutiny and even criticism?

Joseph Gagnon: Some. I think they should get some acknowledgement of some significant progress. But nevertheless, I don't think it's time to let our guard down.

Steve Weisman: It's often said that many other countries have patterned their own currency policies after China. How much should we be concerned about that?

Joseph Gagnon: I think we should be very concerned because I think that even if the Chinese realize that this is a strategy that they can't continue as much as they have and need to gradually get away from -- I think they understand that and believe that; even if they're not moving quite as fast as we would like, they have moved, and I think they understand it. But a lot of other countries see that it has worked for China and they want to start doing it more themselves. So even if China is getting out of this and maybe has a smaller current account surplus in the future, a lot of other emerging markets, really widespread around the world, are actually doing it more and more. They are trying to hold their currencies down to get a big current

account surplus, trade surplus, by exporting to the rest of the world. Everyone wants to grow by having more exports and we can't all do that.

Steve Weisman: Including the United States. Although we aren't perhaps manipulating our currency, but we are accused of that sometimes.

Joseph Gagnon: We're accused of—yes, currency wars. But as I've said in the past, I think we're the aggrieved party, the injured party in that war.

Steve Weisman: It's not just countries in Asia that are following the China pattern?

Joseph Gagnon: No, that's right. It's in Latin America, widespread. A little bit in Africa and Eastern Europe, but also the Middle East. A lot of commodity exporters are doing it, too, for somewhat different reasons, but it's related. High commodity prices are giving them windfall profits in exports and they're saving that money in the United States, which only perpetuates their surplus instead of their spending it on imports or development in their own countries. That would be an alternative strategy, but they're not doing it.

Steve Weisman: What can the United States do about this?

Joseph Gagnon: I think it's widespread and diffuse around the world, so it's hard to fight, China being the obvious example. But they're doing less, so it's hard to pick on them as much anymore. Yet, it accumulates up to a big amount for the U.S. and I think it's tough. Ultimately, the United States could consider doing what many other emerging markets are doing, which is putting controls on capital or even taxing capital inflows to try to discourage them. I mean, ultimately, this is the way these countries do it. Rather than buy our exports, they buy our bonds. If we tax their purchases of our bonds, maybe that would encourage them to buy our exports. But how much of that we can do is difficult to say. And it goes counter to decades of U.S. policy, which was to encourage open capital markets and low taxes.

Steve Weisman: At the annual meetings of the IMF and the World Bank, is this a big issue, as it has been in the past? It seems to have been sidelined.

Joseph Gagnon: It is not the hottest topic right now because the imbalances aren't as big as they were a few years ago. Not that they're not going in the right direction, but at least they're not widening, so they're not getting worse. They're sort of in a holding pattern and I think other topics have just grabbed people's attention, mostly Europe. But a slow-down in China's emerging markets is also, for domestic reasons, an issue again. Is China going to have a property housing bubble burst or something?

Steve Weisman: Thank you, Joe.

Joseph Gagnon: You're welcome.