China and the Presidential Debate: Clarifying the Record

Nicholas R. Lardy explains that contrary to assertions in the debate, China has allowed its currency to appreciate 30 percent in the last seven years. Lardy says that labeling China a "currency manipulator," as Governor Romney advocates, would have little effect in the absence of Congress passing legislation to impose sanctions on China.

Transcript of interview recorded October 17, 2012.

Steve Weisman: The Presidential debate between President Obama and Governor Romney focused at last on China. Nicholas Lardy, senior fellow at the Peterson Institute for International Economics is here with me, Steve Weisman, to discuss what they said, what was correct, what are the implications.

Nick, the issue of China's currency as a factor in trade relations has been around for years. Governor Romney said that China has been a manipulator of its currency and kept its value artificially low. President Obama said their currency had appreciated while he was President. What are the facts?

Nicholas Lardy: I believe the currency was significantly undervalued in the first half of the last decade. Then, beginning in 2005, they de-pegged their currency to the dollar. They allowed it to appreciate gradually. At some periods, it went up more rapidly than others. During the global financial crisis, they slowed that down pretty dramatically. But cumulatively, the currency has appreciated about 30 percent against all of its trading partners. So it has moved since July of 2005.

What has that meant? Back in the middle of the last decade, they had the world's largest external surplus. That is, they were selling so much more to the rest of the world than they were buying from the rest of the world, that it was a source of the global imbalances.

As we measure it by the current account, their surplus was about 10 percent of their GDP. And if you go back to the '90s when Japan was in a supposedly comparable position of being a big surplus country, and the value of the Japanese yen was a big issue economically and politically, especially in the United States, at the peak their surplus was just at about 3.4 percent of their GDP. So China was three times bigger than the previous big notorious case of Japan.

By the first half of this year, their surplus is down to about 2 percent of GDP, so it has declined dramatically, in part because of the increase in value of their currency. Their goods become more expensive internationally. Foreign goods in China become cheaper. And in part, the global slow down has slowed down trade flows. That's also contributed to a reduction in the imbalance.

But we are in a very, very different world today than we were back in 2007 when China's surplus was astronomically large. The IMF used to say their currency was significantly undervalued. They now say it's moderately undervalued. I suspect even that language will be changed once they take into account what has happened over the last eight or nine months.

Steve Weisman: You mentioned in relation to the currencies of its trading partners, but what about against the dollar more specifically?

Nicholas Lardy: Against the dollar, they've also appreciated, but it varies depending on what time period you look at. Remember, in some periods, the dollar is appreciating a lot. Other periods, it's not. So the most accurate way to look at their currency policy is to look at their currency against a basket of their trading partners. On that basis, it's appreciated about 30 percent.

Another indicator of what has transpired is that five-six years ago, and even three-four years ago, China was intervening massively in the foreign currency market to keep their currency from appreciating. They built up to $3.2 trillion in total foreign exchange reserves. But in the last year and a half, there's been almost no change in their foreign currency reserves. They're not intervening. The China Central Bank is not intervening in the market on the scale that they were a few years ago. Indeed they're intervening very, very little.

So I think we're at a point now where you could begin to make the argument that market forces are playing a much, much great role in the determination of the value of the Chinese currency than was the case in the not to distant past.

Steve Weisman: One more question before we go to the issue of manipulation. President Obama said in the debate, I think, that the currency had appreciated 11 percent in his term of office as President. He seemed to be taking credit. Was that fair?

Nicholas Lardy: I think he certainly could take credit for it; it happened on his watch. On the other hand, the currency also appreciated in the last few years of the previous Bush administration, so I think we have to recognize that China did make a fundamental change in its currency policy in the middle of 2005. Appreciation has continued since that time, sometimes more rapidly, sometimes less rapidly. So it's fair for him claiming credit for that, but it didn't start on his watch; it really started in the previous administration.

Steve Weisman: Let's stop there and we'll go to part two of the interview, which is related to the current law in the United States: what would happen if the U.S. labeled China as a manipulator?

Part II

Steve Weisman: This is Steve Weisman again at the Peterson Institute for International Economics with Nicholas Lardy, senior fellow here at the Institute, talking about China and the debate between President Obama and Governor Romney.

We just talked about China's currency appreciating over the last six or seven years. Governor Romney said that if he becomes president, on Day One he's going to label China a manipulator. What does that accomplish?

Nicholas Lardy: It actually accomplishes very, very little. The only statutory requirement in the law is that the Treasury, once it names a country as a manipulator, is required to enter into discussions with that country about the value of its currency, how it might change and so forth. But the reality is the last four or five Treasury Secretaries have negotiated with China on their currency. This has been an ongoing discussion that dates back seven or eight years. I think the practical consequence of naming them a manipulator would be very small. We'd continue to have discussions, presumably. The Chinese have continued to carry out their currency policy as best they thought, and the world wouldn't change. It's a great sound bite. It makes it sound like you're really going to lower the boom, but there's not really much teeth behind it.

Steve Weisman: If it has such little impact, why not do it?

Nicholas Lardy: Two reasons. One. China is the world's second largest economy, the second largest trading economy, the biggest foreign holder of our debt. Do you really want to pick a fight with a country that has those characteristics?

Secondly, there is a possibility that naming them a manipulator would change the outcome of currency bills in the Congress. There have been bills in the Congress introduced repeatedly over the years that, if enacted, would have a substantial effect on China's trade because they in some cases would impose very high tariffs on Chinese products if they didn't move their currency by some predetermined amount.

The downside of those bills is that that kind of an action could set off a trade war that would have very negative repercussions for not only the United States, but the global economy. We have a very, very weak recovery underway today in global trade and we should be adapting policies that encourage the growth of global trade not risking a trade war.

The one exception to my view that naming a manipulator doesn't really have any consequence is that, if the Congress were to pass bills similar to those that have been introduced in the past, it could have very substantial negative consequences, not only for the United States, but the global economy.

Steve Weisman: I think Governor Romney implied that labeling them a manipulator would clear the way for sanctions, but you're saying that can't happen until these laws get passed.

Nicholas Lardy: Right. To put on the kinds of across-the-board tariffs that have been discussed takes an act of Congress. Congress has control over tariffs, and I think there's a view in some quarters that if this President was signaling strongly supporting for this, the vote would be more likely to lead to the passage of that legislation.

Steve Weisman: I would imagine that in each administration there were internal debates about this. It sounds like those who worried that labeling China a manipulator would be needlessly provocative have carried the day.

Nicholas Lardy: Certainly to date that has been the case by both under President Bush and under President Obama. The Treasury has declined to name China a manipulator. So it has been a bipartisan policy for a long, long time.

Steve Weisman: Nick, thank you very much.