Yiping Huang recently argued that the US would not win a currency war over global imbalances. This column agrees that a currency or trade war would be lose-lose. But it says that such a conflict is inevitable unless the root causes of the growing imbalances are addressed.

In a 19 October column on this site, “A currency war the US cannot win”, Yiping Huang argued that comprehensive policy packages in China and the US, including but ranging well beyond exchange rate realignment, are required to achieve the needed global rebalancing. He also argued that progress is already being made on both counts (Huang 2010).

Professor Huang is clearly correct on both points. The US must increase its saving rate, and the household number has risen from zero before the crisis to about 6% now. China can achieve real appreciation of its currency by letting wages rise at a rapid pace, as is now occurring.

Professor Huang is only partially correct, however, in arguing that the imbalances themselves have improved. To be sure, both the Chinese surplus and the US deficit were cut roughly in half from 2006/07 to 2009. This was a result of two things. First, the global recession reduced imbalances, as exports and imports retracted by roughly equal percentages. Second, with the usual time lag of 2-3 years, the currency realignments of 20%-25% by the dollar during 2002-07 and of the renminbi during 2005-2008. Incidentally, contrary to Professor Huang’s assertion that I ignore this progress, I emphasised both improvements in my testimony to the House Ways and Means Committee and the Senate Banking Committee in mid-September.¹

But the imbalances are now rising sharply again, which is why the issue has soared to the top of the global agenda. The US global current-account deficit has moved about halfway back up from its recent trough of $300 billion to its record high of $800 billion. China’s global trade surplus over the past several months is more than 75% above its level of a year earlier and the IMF projects...
that its global current-account surplus will continue rising back to 8% of GDP (about $800 billion, equal to the largest US deficit to date) by 2015 on the basis of current exchange rates and other policies. This goes against the rebalancing strategy agreed upon by the G20, including the leaders of China and the US. It also goes against the economic needs of both countries, with the US experiencing slow growth and China expressing deep concern over overheating. The issue is thus much more urgent, and considerably more serious, than suggested by Professor Huang.

There are several other major analytical errors in his article that have an important bearing on the topic. For example, he suggests that revaluation of the renminbi would not produce net economic benefits for the US. There would be costs, to be sure, mainly from higher prices, yet these are not serious in the short to medium run, however, due to low capacity utilisation and the total absence of inflationary pressures. On the other hand, my colleague William Cline has shown that revaluation of even 20% would curb China’s global surplus by $350-500 billion and reduce the US global deficit by $50-$120 billion, which would translate into 300,000-700,000 good US jobs (Cline 2010). Under current and foreseeable conditions of high unemployment and price stability, currency realignment would thus represent a significant and unambiguous net benefit for the US economy.

Professor Huang also argues that the Plaza Agreement of 1985 failed to rectify the contemporary global imbalances, the highest to date before the current period. To the contrary, again with the usual lags, the US global deficit virtually disappeared by 1990-91 and the Japanese surplus dropped very sharply as well. Those imbalances rose again only when the dollar appreciated sharply, by 40% from 1995 to 2002, and the yen became hugely undervalued in real terms as a result of the deflation that characterised the Japanese economy from 1991 forward.

With respect to my own proposal for countervailing currency intervention, under which the US would sell dollars to offset the exchange-rate impact of China’s purchases of dollars (Bergsten 2010), Professor Huang is correct that the inconvertibility of the renminbi makes it impossible to fully offset China’s massive manipulation. But the US authorities could buy proxies, such as non-deliverable forwards and renminbi-denominated bonds, to the extent they are available and send unmistakeable signals to both the private markets and the Chinese authorities that the time has come to cease resisting the economic fundamentals. This approach, which is aimed at filling the crucial absence of
effective systemic responses to chronic surpluses countries that keep their currencies undervalued (like Japan in the past) and would obviously work better against convertible currencies, is tailored precisely to the problem it seeks to address and is far superior to erecting new trade barriers.

Professor Huang is certainly right that no one would win a currency or trade war. But the root causes of today’s large and growing imbalances, especially the Chinese surplus due to China’s huge and prolonged manipulation of its currency, must be resolved soon or else such conflict is inevitable. The upcoming G20 summit in Seoul may offer a “last best chance” to avoid irreversible reactions in the US Congress and other countries.

References


Huang, Yiping (2010), “A currency war the US cannot win”, VoxEU.org, 19 October.


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