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The World Needs Rebalancing, Not China Alone

Washington's uproar surrounding China's handling of its currency risks becoming more than a trade spat, according to international trade expert Jeffrey E. Garten. If the US labels China a currency manipulator and imposes tariffs on Chinese goods, not only could this action wreck the recovery, as the world economy remains fragile, but it could also boil over into other realms of international relations including sanctions on Iran and climate change. To avert a period of international wrangling that would hurt globalization, Garten recommends a meeting of the US, China, the UK, Eurozone nations, and Japan to work on eradicating trade imbalances. But most important is for the US and China to understand each other's constraints and goals – in many ways the goals of both countries revolve around employment, even if the manner to achieve such an end is vastly different. Without mutual understanding and a lowering of the feral rhetoric, it is not only the US and China that would suffer, the whole world would too. – YaleGlobal

Rather than pointing fingers at each other, the US and China should seek accommodation
Jeffrey E. Garten
22 March 2010

Reaching for the sky: China's soaring trade surplus built on a low exchange rate is a cause of tension.

HONG KONG: As the April 15 deadline for the US Treasury to designate China as a "currency manipulator" approaches, the air is charged with electricity. Both Washington and Beijing have accused each other of engaging in protectionism in their exchange policy. Whatever may be the merit of each side's argument, one thing is certain: US action to force China to revalue by threatening a heavy tariff will bring the world closer to a renewed financial turmoil and a trade war that nobody wants and that would hurt every country.

Beijing vehemently denies the charge that it deliberately undervalues its currency for export advantage and is vowing not to buckle under US pressure. Under US trade laws, the determination of whether China is cheating on its currency must be made in a semi-annual Treasury report. Should that come to pass, the US would be obligated by its own statutes to enter into intensive discussions with China. If those fail, America could impose a hefty tariff on all imports from China – perhaps on the order of 20 percent. The move would not only jeopardize the economies of the two countries, but also endanger the fragile world economy.

Neither Washington nor Beijing are blameless for the escalating financial and trade tensions, but there are ways to avert this potential collision: cool down the mutual accusations, take more time to understand fully one another's dilemmas, and get

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several other countries involved to plan for a new global monetary arrangement.

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Let's stipulate that the Chinese Renminbi is undervalued, perhaps seriously, and let's further acknowledge that a broad swath of the international community accepts the validity of American charges, including several European nations, the IMF, and the World Bank. We can even agree that a stronger exchange rate would help China control its rising inflation and put more goods in the hands of its consumers. The merits of the case aside, however, imposing punitive tariffs on China at this time is playing with fire.

Despite volumes recovering from the double digit drop in 2009, the global trading environment looks much stronger than it is because the recent increase in commerce is from such a low base. A fight between Washington and Beijing could unleash the protectionist pressures that many observers expected to occur in the heat of the financial crisis. These pressures may be rising as unemployment stays painfully high in the West; as the US, Japan and others seek a cheaper exchange rate to boost exports, risking an era of competitive devaluations; and as a long period of budget cutbacks and tax increases characterizes politics in many countries, fanning populist politics. The outbreak of serious trade tensions could, in turn, spook financial markets and precipitate a double dip recession.

The fallout from an acrimonious US-China currency fight could also spill over to a host of security issues. It is true that China has not totally supported proposed US sanctions on Iran, but it has been helpful with North Korea and it hasn't tried to frustrate other American foreign policy goals. From climate change to the containment of nuclear weapons, US-China cooperation is essential.

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The administration should proceed with enormous caution and with a clear understanding of how the world looks through China's eyes and how strongly held is China's position. Although it is fond of megaphone diplomacy – President Obama, the US Treasury, and many Congressmen and Senators have been shouting about the Renminbi in recent daysthe US may need more quiet diplomacy to bring about a change of direction– in Beijing.

For example, many Chinese leaders see an upward adjustment of the RMB as a monumental risk. Because it would raise the price of its exports, China fears a setback in its growth and pressure on jobs at home. In the recent downturn, Beijing had to send 20 million migrants home from the cities, a hair raising episode for a nation so fearful of social unrest. And looking at weak growth in the US and Europe, Beijing shares concerns with nearly all countries about employment in the face of a highly uncertain, yet hypercompetitive global economy.

China believes that a modest revaluation of its currency would have a scant effect on US trade deficits, and that once it made an adjustment, it would be pressed again and again to do more. It is aware that Washington used the same tactics on Japan in the 1980s with no impact on its own trade balances but with severe pressures on the Japanese economy.

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From Beijing's standpoint, moreover, the US has made a total mess of its economy. It has not taken any fundamental long term measures to become more competitive; it has lost its moral authority to preach about sound economic or financial policy; and is now looking for China to bail it out economically and politically. Chinese leaders also believe that their country has been a major stabilizing factor in two global crises – the Asian financial crisis of the late 1990s and the recent one – and deeply resents being targeted now for alleged failings.

At the same time, Beijing should send some trusted emissaries to the US to get a realistic sense of the massive frustrations that are building. They will see that the entire American political establishment is coalescing around pressuring China. That includes the Obama administration, Congress, most of US industry, major editorial boards, and a number of prominent economists known for their moderate and internationalist views. They will see that senior American officials have very powerful short term political motivations to be seen as addressing unemployment, now near 10 percent. Since this is the single biggest issue around which the future of the Obama administration rests, the pressure on China could rise to levels not seen in over 20 years.

The possibility of a major US-China blowup goes beyond lack of mutual understanding. At a time when multilateralism is needed more than ever to cope with the complexities of globalization, both the US and China are showing signs of increasing political insularity. The Obama administration is mired in the complex of jobs, health care, and financial reform, while Beijing wants the world to go away so it can focus on the one billion people who have yet to emerge from dire economic circumstances. The US is a declining power, frantically trying to use tools that worked well in another era but are increasingly problematic now, while China is ascending and increasingly resistant to external demands. Of such contrasts are major miscalculations made.

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The two nations should seek to avoid a confrontation by lowering the rhetoric and by conducting their discussions in a smaller forum that aims to reduce global imbalances and also includes the EU, UK and Japan. Such multilateralism is essential because it is not just China that is running structural trade surpluses but also Germany. An accord among the most important deficit and surplus nations would be a first step to reordering a global economy that for too long relied on the rampant debt-financed consumption by Americans. It could be the most important international negotiation in generations. Failing that, however, we could be headed for a serious economic shipwreck with widespread collateral damage.

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