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Europe could profit from US pressure on China's currency

A US decision whether to label China a currency manipulator in an official report due next month could have international consequences. Europe could profit from a stronger yuan, but has so far kept mum on the issue.

The pressure on the Obama administration to include China in a list compiled by the treasury department of countries that deliberately manipulate their currencies is mounting. Such a move would require Washington by law to start immediate negotiations with China over an adjustment of the yuan.

Talk of an undervalued yuan and what many consider its negative effects for the US economy is not new, but gains traction at least twice a year, that is whenever the US treasury publishes its currency report.

Among international experts there has been little disagreement for some time now that the yuan is in fact significantly undervalued against the dollar. However until now, the US has always made the political decision not to officially name Beijing a currency manipulator. And China has repeatedly rejected claims of an undervalued yen.

But the tide is changing. "It's probably going to be really, really hard for them yet again to fudge on the obvious fact that China is manipulating," said economics Nobel Laureate Paul Krugman at a conference about the issue last week. "Without a credible threat, we're not going to get anywhere."

Getting serious

And this week already 130 lawmakers urged the government to consider sanctions to force China to let its currency appreciate against the US dollar.

With an economy still reeling from the financial crisis, a jobless rate in the double digits, a massive trade deficit vis-a-vis China and an upcoming election there are many political reasons for the US to finally get serious about the perceived currency imbalance.

But politicians in Washington are not just looking for a scapegoat, says Moritz Schularick, an economist at the John F. Kennedy Institute for North American Studies at Free University Berlin. "I think there are good economic reasons and also global economic reasons to ask China to play a more constructive role in the global rebalancing," he told Deutsche Welle.

While China is not to blame for the economic crisis, Schularick argues that its rapid growth and its undervalued currency contributed to the huge economic imbalance between the US and China that was a major factor behind the global financial crisis.

"I think China has to understand that given its size and given the importance it has in the world economy now it has to play a constructive role," he said. "It will have to change its growth model. It will have to help the US economy to get rid off its addiction to cheap money."

Importance of exchange rates

However, his colleague Daniel Gros, director at the Center for European Policy Studies, is skeptical whether a stronger yuan would really have any significant impact:

"My view is that the importance of the exchange rate has been overrated. A revaluation of the yuan

would certainly help to some extent, but I don't think it changes the overall picture," Gros told Deutsche Welle.

"And the overall picture is that in China savings remain very very high and therefore China will remain structurally a savings surplus country for quite some time. A stronger exchange rate might change that a bit at the margin, but wouldn't change the overall picture."

As an historical example, both experts point to the debate between Germany and US in the late 1960's and 1970's about the German mark being undervalued against the dollar. Gros argues that after the German mark was finally revalued, the US did not gain much because Germany's surplus instead of shrinking actually increased.

Schularick takes the same point to contend that the fact that the German economy didn't collapse after the appreciation of the currency serves as an encouragement for China to do the same.

Boost for European exports

While Gros and Schularick disagree about the importance of a currency alignment, both believe that this time the US will include China in its list of currency manipulators, but will not resort to sanctions or tariff increases that would severely threaten Chinese-American relations.

Europe, for its part, would probably profit from a stronger Chinese yuan as well. "Ideally Europe would also want China to revalue and become a more open market for European exporters," said Gros. But since trade between Europe and China is roughly in balance, Europe has not been actively pushing the issue.

"But Europe stands to benefit a lot, because with a revaluation, European products would become more affordable for Chinese consumers and companies alike and we would definitely feel the benefits in terms of better exports," said Schularick.

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