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COMMENTARY

Chasing the Currency Dragon

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So much for the era of personal responsibility. Less than 48 hours after President Obama's stirring call on Americans to sacrifice and put aside "petty grievances and recriminations," Treasury Secretary Timothy Geithner named and shamed China as a currency manipulator, rekindling a political brushfire that has smoldered quietly for years. This despite the fact that the ills supposedly resulting from China's malfeasance are as much the result of past American policies and bad habits as China's effort to prop up its currency. Given the many other wildfires raging in international markets, one would not think that Treasury wanted another conflagration, particularly when it's counting on China to help fight the fires.

The charge cheered some on Capitol Hill who want a more assertive U.S. policy on the issue. It also sent Beijing into a state of raw agitation, something the new administration undoubtedly would have preferred to avoid as it forges its relationship with Chinese. Achieving a balance between mollifying Congress and playing nice with the Chinese is not an easy task, and the currency issue is not unimportant. But bad-mouthing the country you expect to pick up much of the tab for the $825 billion stimulus may not be the best of tactics, no matter how politically expedient. The "manipulator" term has long been understood as a cudgel to be wielded only if all other face-saving measures have been exhausted. Wielding it this early could force a street fight with Treasury's Chinese interlocutors.

The Bush/Paulson strategy was to avoid direct confrontation with China on the issue and pursue quiet diplomacy. For a time it worked. China's currency, the RMB, steadily gained ground on the dollar. But faced with their own economic woes in the wake of the global financial crises, China's policymakers have begun to slow-roll currency reform for fear that a stronger RMB will challenge their exporters and farmers in international competition.

Few responsible analysts suggest that China's currency policy has not left the RMB undervalued, or that there are no consequences to that undervaluation. The roots of the current global financial meltdown are deep in the global imbalances that flooded the United States with cheap credit, a process that began before China's emergence but has reached epic heights as China's economy exploded. Those imbalances also have led to, among other things, misallocation of investment within China, the long-term effects of which will be significant.

Still, one can credibly argue that China's currency system has not been a significant factor in the U.S. trade deficit with China, given that the bulk of products imported from China ceased to be made in the United States long before China was a factor in international commerce. Indeed, the undervalued nature of the RMB may have been a net positive for the U.S. economy over the last few years, helping reduce inflation and easing the lives of Americans at lower income levels.

If and when China's currency does appreciate, it won't mean necessarily that the overall trade deficit will decrease, or that Chinese imports will be replaced by goods made at home. Most importantly for the politicians that follow this issue so closely, it is far from certain that the net result will be more jobs or better income levels for poorer Americans. Calling out China for currency manipulation, however, re-conjures a political chimera and threatens to send the U.S. political class on a chase after a beast whose capture will satisfy no one.

The United States has a current account deficit with China because Americans have been addicted to living beyond our means: consuming too much and saving too little. The reason China is able to maintain its currency at a level that outrages many Americans and our political leaders is that every day the United States issues debt instruments to China to finance our overconsumption and failure to save. It is an unhealthy embrace, to be sure, this codependent tango between enabler and addict. Perhaps naming the currency manipulator as such is one step to recovery. But isn't there a need for personal responsibility on the part of the addict to get his own house in order? After all, the enabler can't enable if the addict isn't binging. China can't manipulate its currency if we don't give it the tools to do so.

Attacking China's currency regime without addressing U.S. domestic fiscal prudence is unlikely therefore to be effective in the long run. Launching that attack as the United States needs to go back to international debt markets to finance the U.S. recovery may soften the market for that debt at the worst possible time.

President Obama's beautiful invocation of the American can-do spirit in his inaugural address suggested that his administration will not be afraid to ask Americans to look in the mirror and make tough personal choices. Blaming China for matters that are inevitable outcroppings of U.S. policies and practices is not the best of starts.

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