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As G-20 summit nears, China is unlikely to budge on currency

By Robert J. Samuelson
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The idea of "rebalancing" the world economy is simple. Before the financial crisis, some advanced countries (led by the United States) were overspending, and some poorer countries (led by China) were oversaving. The two offset each other. The big spenders ran large trade deficits, and the big savers ran large trade surpluses. Now, the financial crisis has dampened the overspending. If the big savers don't increase their spending, the world economy faces prolonged slow growth. Countries may battle each other for shares of that weak demand by managing exchange rates, subsidies or tariffs.

This is a formula for economic strife, whether called "currency wars," protectionism or economic nationalism. As wealthy countries wrestle with stubborn unemployment (9.6 percent in the United States, 10.1 percent in France, 20.5 percent in Spain), it will become harder to resist policies that favor local businesses and workers, especially if other countries are doing the same. Avoiding this future is the central issue facing leaders of the Group of 20 economies when they meet this week in Seoul.

In practice, it may boil down to this: Will China change?

The world's second-largest economy has run blatantly mercantilist (that is, discriminatory) economic policies for years. The resulting huge trade surpluses boosted job growth and, while much of the world boomed, they were tolerated. In 2007, China's current account surplus (mainly trade) reached 11 percent of its economy (gross domestic product). But as China has moved up the value chain - from toys to telecommunications equipment - and as the world economy weakened, its surpluses have become more threatening to more countries.

Like Japan before it, China embraced an investment-led and export-led economic model, explains economist Eswar Prasad of Cornell University. Manufacturers receive subsidized land and energy; the exchange rate of the renminbi is controlled and kept depressed, making Chinese exports more competitive on world markets and making imports into China more expensive. Bank lending rates, regulated by government, are also kept low so that companies can borrow cheaply.

The result has been rapid, though lopsided, industrialization. Economic growth has averaged about 10 percent annually for several decades. In modernizing, China shut down or streamlined many inefficient state-owned enterprises; the job loss was substantial, 43 million from 1997 to 2004, says the World Bank. One appeal of new export-oriented companies was to replace those jobs.

In many ways, China's sophisticated economic management is admirable. Periodic warnings that a popped real estate "bubble" would trigger a broad slump have (so far) proved hollow. When housing prices get too high, notes economist Nicholas Lardy of the Peterson Institute, the government raises interest rates, down payment requirements and taxes on speculators (buyers of second, third or more properties). "These let the air out of bubble," he says. Housing prices moderate or fall. Similarly, China alters its exchange rate to sustain rapid economic growth by regulating demand for its exports.

But now this model is encountering political and economic limits. It's not just Americans who resent the unfair export advantage of an undervalued currency; Europeans, Japanese, Mexicans and others are also unhappy. Although no one has imposed tough import restrictions, these are no longer unthinkable. Meanwhile, China's high savings rate frustrates domestic spending. In the United States, gross national saving is about 15 percent of GDP; in China, it's about 50 percent. Savings normally go toward new factories, machinery and offices. But China's domestic needs for these aren't large enough to absorb all that saving.

That's why it needs more consumer spending, lest it export more to compensate for lack of domestic demand. Economists Lardy and Prasad have long advocated measures to increase Chinese household income and spending: a more generous safety net to limit saving for health emergencies and old age; higher bank deposit interest rates so that consumers would earn more on their accounts; requirements for companies to pay dividends and not reinvest most retained profits.

The Chinese know this. They even embrace the goal of stimulating consumer spending and are trying to do so. But until they succeed, they won't relinquish the crutch of an undervalued exchange rate. "Do not work to pressurize us on the renminbi rate," Prime Minister Wen Jiabao recently warned. Exporters would close; workers would lose their jobs. "If China saw social and economic turbulence, then it would be a disaster for the world." Jobless workers elsewhere may find this argument unpersuasive.

If China resists global rebalancing, it won't happen regardless of what this week's communique from Seoul pledges. The omens seem unpromising. The United States has let the dollar depreciate to cut its trade deficit. Because the renminbi is pegged to the dollar, the depreciation actually improves China's export competitiveness against some countries. All this looks less like rebalancing than a dogfight - among China, the United States and others - for competitive advantage.

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