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China's Currency Allies

Some U.S. Economists Urge Beijing Not to Ease Grip on the Yuan

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WASHINGTON -- When Stanford University economist Ronald McKinnon visits China, at times he is mobbed by students asking him to autograph his latest book, "Exchange Rates under the East Asian Dollar Standard: Living with Conflicted Virtue."

Why the celebrity reception for the author of an economics textbook? One reason is Mr. McKinnon argues China should resist the Bush administration's hectoring and refuse to abandon its policy of keeping the value of its currency, the yuan, nearly locked to the U.S. dollar. Allowing the yuan to rise significantly, he warns his Chinese audiences, could send China into the kind of deflationary slump that hit Japan in the 1990s.

His signature closing line during speeches in China: "Don't let what happened to Japan happen to you by letting go of the exchange rate."

It is a given at the White House and the Treasury Department, on Capitol Hill, inside many manufacturers' executive suites and among numerous economists that the world would be a better place if China allowed the yuan to rise significantly against the dollar.

Tomorrow, the Treasury Department is scheduled to release its semiannual foreign-exchange report, in which it could formally accuse Beijing of manipulating the yuan's value to gain an edge in global trade. Speculation over such a move has roiled Asian currency markets in recent days. When the last report was issued, Treasury Secretary John Snow implied that time was running short for Beijing to make the exchange rate substantially more flexible.

Mr. McKinnon is one of a well-credentialed group of U.S. economists urging China to resist U.S. demands. "There is very significant concern among a lot of economists about the pressure being put on China to revalue at gunpoint," says Benn Steil of the Council on Foreign Relations, who attended a closed-door meeting last month among top Treasury officials and a number of academics.

American manufacturers and their allies in Congress have argued for several years that China is, in effect, cheating in international trade by keeping the yuan weak against the dollar. The exchange rate, they say, makes Chinese goods artificially cheap in the U.S. and American goods artificially expensive in China, costing U.S. factory jobs.

Administration economists don't buy industry's argument that U.S. manufacturing woes are caused by the yuan. But they know they have to cool the political heat. Besides, they argue, a flexible exchange rate would prove beneficial to China itself.

Since last July, Chinese officials have allowed the currency to rise more than 3% against the dollar. But it is not clear how far or fast they are willing to go.

In the meantime, the American rebel economists are handing Beijing the intellectual arsenal to fend off U.S. demands.

Joseph Stiglitz of Columbia University, who won the Nobel Prize in 2001, took his case directly to Chinese Premier Wen Jiabao during two gatherings in China last year. At one event, Mr. Stiglitz warned China it would be unwise to risk the stability of its currency.

Furthermore, he said in an interview last week, it isn't clear the yuan's exchange value would climb if Beijing liberalized its markets. A rush of Chinese capital into foreign investments might weaken the yuan, he warns.

Even if the yuan climbed more, American consumers would probably buy their imported goods from some other Asian country, he says. "The problem of our trade deficit is not going to be solved by China's exchange rate," says Mr. Stiglitz, who argues that cutting the federal budget deficit would be far more effective.

Another Columbia University Nobel laureate, Robert Mundell, reminded the Chinese last year that during the Asian financial crisis of the late 1990s, the U.S. had pressed China not to let the yuan weaken for fear of setting off a destabilizing round of competitive devaluations across Asia. In an address at the Chinese University of Hong Kong, Prof. Mundell listed a dozen "harmful effects of yuan appreciation." They included: an economic slowdown in Asia, reduced foreign investment in China and increased unemployment in China.

The criticism from such economic luminaries irks some in President Bush's administration, but doesn't sway them.

"They're distinguished economists who have contributed a lot," says John Taylor, a Stanford economist who served as undersecretary of the Treasury for international affairs until last year. "You have a couple of Nobel Prize winners on that list. They're influential. That doesn't mean they're right."

Treasury spokesman Tony Fratto says the big-name critics unfairly accuse the Treasury of pressing China to allow the yuan to move unfettered against the dollar. What the Treasury really wants, Mr. Fratto says, is for Beijing to allow more flexibility in the exchange rate with the distant goal of a free float.

"When critics set up these straw men to knock down, do they have any influence on us?" Mr. Fratto asks. "No, because they're not arguing on point."

Some of the critiques hit close to home. Albert Keidel, who spent three years in the Bush Treasury Department, describes the U.S. position as political. "This is one where the administration really needs to cover itself so it can't be accused of being soft on China," Mr. Keidel says.

Stanford's Mr. McKinnon argues the U.S. pressure on Japan in the 1980s to let the yen rise contributed to the doldrums of the 1990s. When he sat down with the Treasury's international team last month, Mr. McKinnon presented a two-page brief slamming its China policy. "One cannot rule out the possibility of a Japanese-style deflationary slump if China is continually forced to appreciate the renminbi because bad economic theory suggests that a higher renminbi will eventually reduce its trade surplus," he wrote. Mr. Fratto declined to comment on the meeting.

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