FT.com FINANCIAL TIMES

PRINT THIS

Joseph Stiglitz answers questions on China and the revaluation of the renminbi
>Published: July 26 2005 19:18 | Last updated: August 2 2005 03:43

>>

>>

Joseph Stiglitz, Nobel Prize winner in economics in 2001, answers questions on China, the US and the global economy.

To view our audio-visual presentation on the revaluation of the renminbi, click here

Click here for Joseph Stiglitz on why the US has little to teach China about steady economy

....

Q: How long will China's rapid growth last? Martin Wolf, FT's chief economic commentator, said "the era of China's rapid catch-up growth could well be in its middle, not at its end". Do you hold the same opinion? What will be the main hurdles?
>Binghua (Ben) Zhang, Senior Business Analyst, Marine Business Development, Lloyd's Register

Joseph Stiglitz: I agree with Martin Wolf. The gap between China and the advanced industrial countries remains large. But the heavy investments in education and the closer integration of China into the global economy has put China in a position to close this gap at a rate, perhaps even faster than it has been closing that gap in the past.

One of the challenges will be to avoid the excesses that have marked market economies from the beginning - periods of overinvestment followed by recessions. China has had fluctuations, but it has avoided recessions. It seems to be modulating the seeming over-investment in certain sectors. It will be important for it to continue to do this in the future.

....

Q: What do you think of the Bernanke notion that the US current account deficit can be explained by a global savings glut? Is there anything wrong with developing economies like China providing a large portion of the pool of savings that finances US consumption and investment?
>David Gilmore

Joseph Stiglitz: The US current account deficit is most directly related to the gap between domestic investment and domestic savings. The fiscal deficit has contributed, of course, to the low level of American national savings. The high level of savings in the global economy and the low level of investment helps explain why the United States can finance the trade deficit at such low interest rates. If China succeeds in encouraging consumers in its country to consume more and save less, the global balance of savings and investment will change; interest rates are likely to rise; but the American trade deficit will not be much improved - except if the higher interest rates lead to lower investment: not a pretty way for the trade deficit to be reduced.

....

Q: Given that CNOOC has withdrawn from the battle for Unocal, what use does China have for its huge dollar reserves? Since China has more than enough dollars to buy oil and other commodities denominated in dollar, should China, and other Asian countries, not start thinking about trading with countries whose currencies can be used to buy goods and services they need as well as overseas assets important to them?
>**Dipak Ghosh**

Joseph Stiglitz: Attempts to block the purchase of Unocal are foolish. Much, if not most, of its assets are in Asia, and if China doesn't acquire these assets, it will acquire others. America has fought hard for opening up investment markets all around the world. America now appears to be hypocritical

....

Q: Most Europeans corporations in direct competition with China are mounting pressure on Brussels to curb Chinese imports by re-imposing trade barriers. Why are European bureaucrats giving credit to an approach that is against the rules of a liberal economy advocated by Barroso, the current president of the EU Commission?
>Eric Fapom, Senior Analyst, Capital Markets Intelligence Corporate, Investment Banking Investment Management, Thomson Financial (Milan)

Joseph Stiglitz: When I was in the White House, I saw repeatedly: everyone believes in no subsidies and strong competition - except for themselves. American and European corporations believe in free markets, but are not above asking for government help, either in the form of protectionism or subsidies. Of course, they also will claim that they believe in free and FAIR trade, and if only trade was fair, they would not be asking for government help. But each country has its strengths and weaknesses - that's why there's trade in the first place. China has some advantages - inexpensive labour; but it suffers from the many disadvantages that a less developed country suffers from.

One of the big advances of the WTO was the beginnings of the creation of a rule of law. The

U.S. was stopped from imposing duties on steel, subsidies on cotton, subsidies through the tax system on exports, etc. It will take a long time before we really believe in what we preach - a liberal, competitive economy.

....

Q: If other countries follow suit (China not to export inflation) and re-evaluate their currencies, will we witness wholesale inflation across Asia (eventually to America)?
>Patrick Ng, Houston, Texas

Joseph Stiglitz: China's revaluation was so small that it is likely to have a negligible effect on inflation anywhere. Obviously, a much larger revaluation would have more significant effects - but the effect on inflation would depend crucially on how central banks respond. For instance, it will have a deflationary effect on China, but an inflationary impact on the United States (especially if other countries follow China and Malaysia's lead).

If the Fed responded by raising interest rates, ironically, a measure intended to improve America's economic performance by increasing net exports, it would actually lead to a slowdown of the US economy.

....

Q: Why does China have such a high personal savings rate after so many years of communist central economics?
>**Piers Harden, LME Sales Executive**

Joseph Stiglitz: China's savings rate is indeed impressive - close to (if not more than) 50%. Part of the explanation has to do with the rapid rise in incomes - consumption has not kept pace. Many may worry that it will not be sustained - they can still remember when things were not so good. (This happened in other countries in East Asia during the period of their rapid increases in income)

Part of the reason has to do with an inadequate public provision of social services, for instance, for retirement and health. The government has been trying to discourage savings, so far to little avail. One suggestion has been to improve their public social security (retirement) system.

....

Q: China is experiencing both social unrest and environmental disasters in numerous rural areas that may trigger shortages of domestically-produced food and thus increase food imports. How serious are theses issues regarding the overall development of China and the global agricultural commodities markets?
>Bertrand Montel

Joseph Stiglitz: It is difficult to estimate the quantitative significance of these problems. So far, they appear to have at most a negligible impact on China's overall performance - and accordingly on global markets.

....

Q: What do you think about last G8 meeting decisions? How do you assess developed countries' contributions in the war against poverty?
>Abeer Abou Shammala

Joseph Stiglitz: Forgiveness of multilateral debt was a major step forward - assuming that there is follow-through on the promise. But its not enough: (a) there has to be more forgiveness of bilateral debts - which in some cases (such as Nigeria) are even more important than the multilateral debt; (b) there are more countries that need debt forgiveness; (c) there needs to be an increase in annual aid giving; (d) the trade regime needs to be reformed to open up developed country markets and reduce agricultural subsidies, which in some cases do more harm than the value of the aid the countries receive; (e) the global financial system has to be made more stable; and (f) more of the risk of interest rate and exchange rate fluctuations has to be shifted from developing countries to developed.

....

Q: Will the appreciation of the renminbi have a big influence on the foreign exchange market? Do you believe the US economy is the structural problem? Does China's revaluation policy bring any real advantage to China?
>**Wang Yuyang, China**

Joseph Stiglitz: The appreciation was too small to have a big influence on the foreign exchange market - one saw some adjustments, for instance, to the yen, but any adjustments are in part a response to anticipations of further changes.

Yes, the fundamental source of global imbalances at the current time is the huge U.S. trade (and fiscal) deficit.

The revaluation has little benefit - or cost - to China. There is a short term political benefit, reduces U.S. political pressure, but only short term - pressure will mount again with the continuing huge bilateral trade deficit and the weak labour market conditions in the U.S.

....

Q: To what extent are the present conditions for rapid industrialisation in mainland China motivated by the government's fear of unrest among its peasants?
>Floyd Arntz

Joseph Stiglitz: China's government is, I believe, committed to increasing the well-being of its citizens. It is, one might say, part of the basic ideology, their belief system about what the government should do. But it is also the case that the government's legitimacy comes in no small measure from the country's economic success. Fear of unrest may, of course, also play a role.

Maintaining the economy's high growth and employment is both a strategy for increasing the country's economic strength and strengthening citizens' confidence in the government.

....

Q: Can the US afford to allow China to grow unchecked economically and militarily even if it becomes a full-blown market economy?
>Umnuay Sae-Hau

Joseph Stiglitz: China's growth is mutually beneficial, as markets for America's goods (like Boeing aircraft) increase enormously. Moreover, it is not clear that the United States could stop China's economic growth without imposing enormous costs on itself, and without violating existing international trade agreements.

....

Q: What sustainable measure could China take to reduce inflation?
>Kenneth Cheng

Joseph Stiglitz: Inflation remains moderate in China. China needs to continue to use administrative controls to limit excess investment in overheated sectors, like real estate. The revaluation will lower costs of inputs, but it is so small as to have a negligible effect.

....

Q: To guarantee its oil supply, China is moving to secure oil at source and has signed an agreement with Iran to supply oil to China for the next 20 years. Yet the US is still making threatening noises against Iran.

How dependent is China on this agreement with Iran and how would military action against Iran affect the Chinese economy?
>Adil Allawi

Joseph Stiglitz: Oil is a global commodity, which can be purchased by anyone willing to pay market prices. Long term contracts are useful in helping countries avoid the huge fluctuations in prices in spot markets. (There have been very few occasions in which there has been rationing, so that one cannot buy oil in the spot market.) US geopolitical actions, which have contributed immeasurably to instability, are leading countries, including China, to seek diversified sources of oil, to reduce their need to resort to spot markets.

At this point, any action in Iran is likely to have a limited effect on the Chinese economy - though clearly, it, like any other country, would suffer somewhat from the large disruption in global energy markets that might result.

....

Q: What would the perspectives be for the next 10-15 years about a possible US/China conflict?
>Felipe Tezotto, Brazil

Joseph Stiglitz: Such a conflict would not be either country's interests. It is not just a matter of peaceful co-existence: both the United States and China have benefited enormously from the economic relationship.

China has been focusing its attention on strengthening its economy. It surely knows that every dollar spent on the military is money that could have had much higher returns invested elsewhere. It also knows that there is little point in a wasteful arms race. On the other hand, any government must spend the amount it needs to defend itself. America has been spending large amounts on arms systems that won't work against enemies that don't exist. But the huge expenditures cannot but give rise to anxieties elsewhere in the world, especially in light of demonstrated American unilateralism.

....

Q: I always read with great interest your perspective about the present and future of the world economy, I would like to ask you if there is in your opinion any economic future at all for countries like Cuba or North Korea and if you could be heard by those country's leaders what would be your recommendation to them.
>**Jose Perez, US**

Joseph Stiglitz: There is a distinction between North Korea and Cuba. North Korea's economic isolation is self-chosen. Cuba's is imposed on it by the United States. Neither system has performed well, but at least Cuba has brought health and education benefits to large numbers of people who previously did not have them.

....

Q: Do you still believe, as the theory of competitive advantage suggests, that the US and China will both be better off when, in many years from now, a trade equilibrium is reached? Or will it result in a state of affairs where the US is poorer, and China richer than today, with a loss of global influence to go with it for the US? Wouldn't the US be better off putting up trade barriers, and do all it can to preserve its position as the world's biggest economy?
>**Roeland Schatz**

Joseph Stiglitz: The theory of comparative advantage still holds: opening up trade holds out the promise of making both countries better off than they would be without trade. American consumers gain enormously from low priced Chinese goods. But some Americans - especially low wage American workers - may be markedly worse off. And America may clearly lose as China becomes a tough competitor in markets around the world.

....

Q: What does China's last move on the renminbi mean for the global financial system, particularly for Europe and for the United States ? How will it affect countries like Turkey?
>**Ali Murat Ersoy**

Joseph Stiglitz: The move itself is likely to have few direct consequences - it simply was too small. China has signalled that it is not wedded to the old exchange rate - something that it had already repeatedly said - but it is not clear the size of its eventual adjustment.

A much larger adjustment is likely to lead to a variety of adjustments in trade and exchange rates around the world. For instance, countries that compete with China in selling textiles would be likely to gain market share.

Tracing out the full ramifications is, however, not easy. If China has a smaller trade surplus, will it buy fewer U.S. treasury bills? Who will make up the slack in financing the huge U.S. fiscal deficit? Will U.S. interest rates rise? Will that slowdown the American economy?

....

Q: In view of the revaluation of the renminbi, would you suggest India to re-value its currency?
>**Shivam Rajagria**

Joseph Stiglitz: Not at this juncture. India would benefit from a stronger export boom. Why dampen it?

....

Q: Do you draw parallels between Japan's Yen revaluation in the early 90's and the renminbi revaluation as both came under American pressure?
>**Yik Siong Tay**

Joseph Stiglitz: My impression is that Japan’s revaluation was much more a consequence of market forces, while China’s is clearly driven by politics.

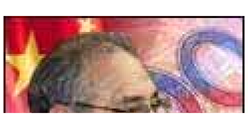
....

Q: What would be the effect of a yuan mayor revaluation on developing countries' currencies against the dollar? (ie Mexico's peso)
>**C.Mena-Labarthe**

Joseph Stiglitz: There is no simple answer. Many developing countries have benefited enormously from China’s robust growth. If the revaluation slows down China’s economy, there will be adverse effects on their growth. On the other hand, many developing countries compete directly with China, e.g. in textiles, and a major revaluation would help them and their growth

....

Joseph Stiglitz: US has little to teach China about steady economy



>As excitement over China’s revaluation has died down – including jubilation by some of the speculators, who have at last earned an (albeit

modest) return – it is time for a calmer assessment about what it does and does not mean for China, for the US and for the global economy.

There remains considerable uncertainty. Though China has demonstrated a willingness to adjust its exchange rate, we do not know what will follow; will the total adjustment over the next couple of years be 10 per cent or 40 per cent? The speculators, surely, will be betting on more. And as China wisely sterilises these inflows, we can expect a continuing build-up of reserves, with this being used by speculators and their allies as an argument for further revaluation. But China will, hopefully, see through this.

The key question is how the appreciation will affect global imbalances, China's trade surplus and the US trade deficit and what, if any, will be the knock-on effects. America's trade deficit of $700bn is nine times China's trade surplus. China's economy has been going gangbusters; rapid growth with little inflationary pressure. The revaluation will hardly make a dent. Even larger revaluations are not likely to do much to the global imbalances.

First, we do not know accurately the size of China's surplus because, in an attempt to circumvent exchange controls, there is over-invoicing of exports and under-invoicing of imports – part of speculative flows. The large import content of China's exports, particularly to America, mean that China's competitiveness will be little affected. Economists disagree about whether the import content for exports to America is 70 per cent or 80 per cent but, whatever the number, it means that the effective appreciation was almost certainly under 1 per cent. In the case of a larger revaluation, Chinese companies would probably respond to the loss of competitiveness by cutting margins, reducing further the effect of the revaluation. This revaluation – even if followed by further moderate ones – is likely only to slow the rising tide of China's exports slightly.
>
>

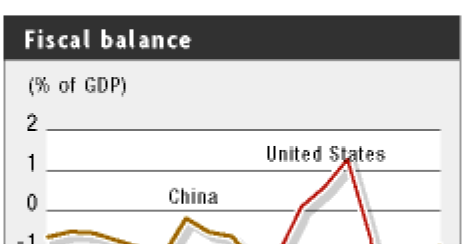
>But whether this, or a succession of revaluations, eliminates China's trade surplus will have little effect on the more important problem of global trade imbalances, and particularly on the US trade deficit. Much of China's recent gains in textile sales, for instance, after the end of quotas last December, came at the expense of other developing countries. America will once again be buying from them, and so total imports will be little changed.

More fundamentally, the trade deficit equals capital inflows, and capital inflows equal the difference between domestic investment and domestic savings. That is why, normally, when the fiscal deficit goes up (so domestic savings goes down), the trade deficit goes up. Neither President George W. Bush nor John Snow, the US Treasury secretary, has explained how China's revaluation will change these basic equations. Unless domestic investment goes down or domestic savings go up, the trade deficit will persist, unabated. The trade deficit could diminish but if it does, it will not be a pretty picture. Domestic investment, for instance, could go down if we succeed in getting our wish and China's trade surplus disappears; with China no longer using the money from its trade surplus to fund our huge fiscal deficit, medium- and long-term interest rates would rise. The economic downturn, and the decrease in investment, would be compounded if the increase in interest rates pricked the housing bubble.

There is a myth of mutual dependence: China needs to export goods to the US, which needs China's money to finance its deficit. But China could easily make up for the loss of exports to America – and the wellbeing of its citizens could even be improved – if some of the money it lends to the US was diverted to its own development. China has huge investment needs. If its government is going to lend money, why not finance its own development? Why not fund increased consumption at home, rather than that of the richest country in the world, to pay for a tax cut for the richest people in the richest country, or to fight a war which most view as anathema? But the US could not so easily make up for the gap in funding without large increases in interest rates, and these could play havoc with the economy.

>There is a second myth: that China would benefit from letting its exchange rate float freely, letting market forces set the price. No market economy has foresworn intervening in the exchange rate. More to the point, no market economy has foresworn macroeconomic interventions. Governments intervene regularly in financial markets, for instance, setting interest rates. Some market fundamentalists claim that governments should do none of this. But today, no country and few respectable economists subscribe to these views. The question, then, is what is the best set of interventions in the market? There is a high cost to exchange rate volatility, and countries where governments have intervened judiciously to stabilise their exchange rate have, by and large, done better than those that have not.

Exchange rate risks impose huge costs on companies; it is costly and often impossible to divest themselves of this risk, especially in developing countries. The question of exchange rate management brings up a broader issue: the role of the state in managing the economy. Today, almost everyone recognises that countries can suffer from too little government intervention just as they can suffer from too much. China has been rebalancing and, over the past two decades, markets have become more important, the government less so. But the government still plays a critical role. China's particular blend has served the Chinese well. It is not just that incomes have been rising at an amazing 9 per cent annually, and that high rates have been sustained for more than two decades, but the fruits of that growth have been widely shared. From 1981 to 2001, 422m Chinese have moved out of (absolute) poverty.



>The US economy is growing at a third the pace of China's. Poverty is rising and median household incomes are, in real terms, declining. America's total net savings are much less than China's. China produces far more of the engineers and scientists that are necessary to compete in the global economy than the US, while America is

cutting its expenditures on basic research as it increases military spending. Meanwhile, as America's debt continues to balloon, its president wants to make tax cuts for the richest people permanent. With all this in mind, China's leaders may not feel they need to seek advice from the US on how to manage either the exchange rate or the economy.

>

Sources for charts: IMF; EIU; ADB

>

>

>

Find this article at:
http://news.ft.com/cms/s/79797f04-fe00-11d9-a289-00000e2511c8,dwp_uuid=2aaa1c16-afc8-11d9-ab98-00000e2511c8,ft_acl=_ftalert_ftarc_ftcol_ftfree_ftindsum_ftmywap_ftprem_ftspecial_ftsurvey_ftworldsub_ftym_ftymarc_ic_ipadr

☐ Check the box to include the list of links referenced in the article.