

Economist urges caution on U.S. approach to China

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As U.S. legislators consider a bill to force China to raise the value of its currency, a China trade expert and former International Monetary Fund economist warned that being confrontational would cause more harm than good.

In testimony before the Senate Finance Committee, Eswar Prasad, a senior professor of trade policy at Cornell University, said drastic U.S. policy actions over the currency would simply poison U.S.-China relations.

"Furthermore, this approach is unlikely to have a large or lasting impact on problems such as the U.S. trade deficit or imbalances in the Chinese economy, and could make matters worse for everyone by creating instability in the global economy," said Prasad, who worked on China issues as a research economist at the IMF until he left late last year.

He said the United States could work with China in a way that generated results rather than just "kicked up a lot of dust."

Prasad said it would be more helpful if the United States worked with China to transform its economy.

"This would be win-win international financial diplomacy -- it would improve Chinese macroeconomic performance and defuse tensions abroad," Prasad added.

The U.S. legislation is being developed by two Democrats and two Republicans that would force China to raise the value of the yuan against the dollar.

Many U.S. lawmakers and manufacturers believe the Chinese yuan is undervalued by as much as 40 percent, which gives Chinese firms an unfair price advantage in global trade.

The so-called "veto-proof" bill would need two-thirds support in both the U.S. House of Representatives and the Senate to protect it from a veto by President George W. Bush.

But Prasad argued that greater flexibility of the yuan, while important, was "hardly an end in itself".

It was more important to focus on what monetary policy framework would replace a fixed Chinese exchange rate that had helped China anchor inflation expectations, he added.

Prasad suggested China adopt an inflation objective -- a long-run target range -- as a new anchor for monetary policy.

"An inflation objective, coupled with exchange rate flexibility, would work best to stabilize the Chinese economy and enable policymakers to deal nimbly with various domestic and external shocks," he said.