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**World Out of Balance**

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International travel by world leaders is mainly about making symbolic gestures. Nobody expects President Obama to come back from China with major new agreements, on economic policy or anything else.

But let’s hope that when the cameras aren’t rolling Mr. Obama and his hosts engage in some frank talk about currency policy. For the problem of international **trade imbalances** is about to get substantially worse. And there’s a potentially ugly confrontation looming unless China mends its ways.

Some background: Most of the world’s major **currencies** “float” against one another. That is, their relative values move up or down depending on market forces. That doesn’t necessarily mean that governments pursue pure hands-off policies: countries sometimes limit **capital outflows** when there’s a run on their currency (as Iceland did last year--2008) or take steps to discourage **hot-money inflows** when they fear that **speculators** love their economies not wisely but too well (which is what Brazil is doing right now). But these days most nations try to keep the value of their currency in line with long-term **economic fundamentals**.

China is the great exception. Despite huge **trade surpluses** and the desire of many investors to buy into this fast-growing economy — forces that should have strengthened the **renminbi**, China’s currency — Chinese authorities have kept that currency persistently weak. They’ve done this mainly by trading renminbi for dollars, which they have accumulated in vast quantities.

And in recent months China has carried out what amounts to a **beggar-thy-neighbor** **devaluation**, keeping the **yuan**-to-dollar **exchange rate** fixed even as the dollar has fallen sharply against other major currencies. This has given Chinese exporters a growing competitive advantage over their rivals, especially producers in other developing countries.

What makes China’s currency policy especially problematic is the depressed state of the world economy. Cheap money and **fiscal stimulus** seem to have **averted** a second Great Depression. But policy makers haven’t been able to generate enough spending, public or private, to make progress against mass unemployment. And China’s **weak-currency policy** **exacerbates** the problem, in effect **siphoning** much-needed demand away from the rest of the world into the pockets of artificially competitive Chinese exporters.

But why do I say that this problem is about to get much worse? Because for the past year the true scale of the China problem has been masked by temporary factors. Looking forward, we can expect to see both China’s trade surplus and America’s **trade deficit** surge.

That, at any rate, is the argument made in a new paper by Richard Baldwin and Daria Taglioni of the Graduate Institute, Geneva. As they note, trade imbalances, both China’s surplus and America’s deficit, have recently been much smaller than they were a few years ago. But, they argue, “these global imbalance improvements are mostly **illusory** — the **transitory** side-effect of the greatest trade collapse the world has ever seen.”

Indeed, the 2008-9 plunge in world trade was one for the record books. What it mainly reflected was the fact that modern trade is dominated by sales of **durable** manufactured goods — and in the face of severe financial crisis and its attendant uncertainty, both consumers and corporations postponed purchases of anything that wasn’t needed immediately. How did this reduce the U.S. trade deficit? Imports of goods like automobiles collapsed; so did some U.S. exports; but because we came into the crisis importing much more than we exported, the net effect was a smaller **trade gap**.

But with the financial crisis **abating**, this process is going into reverse. Last week’s U.S. trade report showed a sharp increase in the trade deficit between August and September. And there will be many more reports along those lines.

So picture this: month after month of headlines **juxtaposing** soaring U.S. trade deficits and Chinese trade surpluses with the suffering of unemployed American workers. If I were the Chinese government, I’d be really worried about that prospect.

Unfortunately, the Chinese don’t seem to get it: rather than face up to the need to change their currency policy, they’ve taken to lecturing the United States, telling us to raise interest rates and curb **fiscal deficits** — that is, to make our unemployment problem even worse.

And I’m not sure the Obama administration gets it, either. The administration’s statements on Chinese currency policy seem ***pro forma*** , lacking any sense of urgency.

That needs to change. I don’t begrudge Mr. Obama the banquets and the photo ops; they’re part of his job. But behind the scenes he better be warning the Chinese that they’re playing a dangerous game.

**Glossary**

**abating** – *becoming smaller or less intense*.

**averted** – *turned away from an undesirable obstacle*.

**beggar-thy-neighbor** – *international trade policy that benefits the country that enacted it, while harming its neighbors or trade partners*.

**capital outflows** – *investment flowing out of particular economy.*

**currencies** – *money that is in circulation*

**devaluation** – *the reduction in the official value of a currency in relation to other currencies*.

**durable** – *long-lasting*.

**economic fundamentals** – *for example, business cycle phases, interest rates, inflation rates, etc.*

**exacerbates** – *makes a situation worse*.

**exchange rate** – *value of one currency for the purpose of conversion to another*.

**fiscal deficits** – *same as* **budget deficits**.

**fiscal stimulus** –*increasing government consumption or transfers or lowering taxes*.

**hot-money inflows** – *the flow of funds from one country to another in order to earn a short-term profit on interest rate differences.*

**illusory** – *not real*.

**juxtaposing** – *placing two contrasting items next to each other*.

***pro forma*** - *as a matter of standard form or politeness*.

**renminbi** – *similar to the U.S. dollar or the U.K. pound.*

**siphoning** – *draw off or transfer over a period of time, especially illegally or unfairly*.

**speculators** – *people who analyze and forecast futures price movement, trading contracts with the hope of making a profit.*

**trade deficit** – *when a country’s imports exceed its exports*.

**trade gap** – *same as* **trade deficit**.

**trade imbalances** – *A country's trade balance is a reflection of what it spends minus what it produces. In surplus countries income exceeds their spending, so they lend the difference to countries where spending exceeds income, accumulating international assets in the process*.

**trade surpluses** – *when a country’s exports exceed its imports.*

**transitory** – *not permanent*.

**weak-currency policy** – *devaluation of one’s currency in order to boost exports, shrink trade deficits, and reduce payments on government debt payments*.

**yuan** – *the yuan is similar to calling a dollar a “buck” or a pound a “quid.”*