Krugman Says China Yuan Policy Depresses Global Economic Growth

By Rebecca Christie
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Nobel Prize-winning economist Paul Krugman said global economic growth would be about 1.5 percentage points higher if China stopped restraining the value of its currency and running trade surpluses.

Krugman said China's currency policy has a "depressing effect" on economic growth in the U.S., Europe and Japan, as measured by gross domestic product. If China's currency, the yuan, were not undervalued, it would have a "significant" impact on the global recovery, he said.

"If we could get some change in China's currency policy, it would help the world," Krugman said today at an Economic Policy Institute event in Washington.

The U.S. has refrained from calling China a currency manipulator, while also criticizing its lack of flexibility in foreign exchange policy. The Chinese central bank has kept the yuan at about 6.8 per dollar since July 2008, as part of stimulus efforts to help China weather the global recession.

The International Monetary Fund predicted in January the world economy will expand 3.9 percent this year after a contraction of 0.8 percent last year. China's economy was forecast to grow 10 percent this year and 9.7 percent next, the IMF said.

Krugman said the world economy wouldn't be hurt, and could benefit, if China were to sell off a large portion of its dollar-denominated assets. He said that if China were to sell all of its U.S. investments, it would help the economy by acting as a form of quantitative easing and fighting a "liquidity trap" that has recently been affecting the U.S. economy.

China's Response

"We should not be afraid of what the Chinese might do if we pressure them to stop this currency manipulation," Krugman said.

At the end of 2009, China was the top foreign investor U.S. government debt, with holdings of $898.4 billion in Treasury securities.

Krugman said the U.S. may need to get more aggressive in its negotiations with China, perhaps by treating the exchange- rate issue as a countervailing duty or other export subsidy.

“Without a credible threat, we’re not going to get anywhere,” he said. “The chance that we would trigger a trade war is very small and it’s hard to see any alternative.”

The U.S. Treasury Department is due to issue its semiannual report on foreign exchange markets next month.

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