THE WALL STREET JOURNAL.
WSJ.com

OPINION | OCTOBER 26, 2010

Geithner's Global Central Planning

The Chinese government's accumulation of U.S. debt represents a tragic investment decision, not a currency-manipulation effort.

By JOHN H. COCHRANE

Economists are full of bad ideas. Terrible ideas seem to emerge when the gurus get together to talk about coordinating their bad ideas. Last week's public letter from Treasury Secretary Tim Geithner to the G-20 finance ministers is a great example.

Mr. Geithner starts with a dramatic proposal: "G-20 countries should commit to undertake policies consistent with reducing external imbalances below a specified share of GDP [later reported to be 4%] over the next few years."

Since when is every trade surplus or deficit an "external imbalance" in need of correction? It makes sense for a country that has good investment prospects to import a lot of goods, run trade deficits, and borrow money. Years later, the country puts the resulting products on boats to pay the lenders back. The U.S. borrowed abroad to finance our railroads in the 19th century and ran surpluses when Europe was rebuilding after World War II. Were these "imbalances"?

Or consider a country (say, China) with a lot of middle-aged workers who need to save for retirement. It makes perfect sense for them to put stuff on boats and send it to a second country (say, the United States) whose people want to consume the goods. The people in the first country invest their earnings, say, by buying the bonds issued by the second country. And as they retire, they cash in the bonds and buy goods flowing the other way.

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Martin Kozlowski

Do these and similar stories exactly account for current trade patterns? I don't know. But nobody else does, either. In particular, the army of economists in the basements of the International Monetary Fund (IMF) has no clue exactly how much each country should be saving, or where the best untapped global investment opportunities are around the world—including whether trade patterns are "normal" or "imbalanced."

So what policies would Mr. Geithner have countries undertake to bring economies around the world into his idea of better balance? He says that G-20 "countries running persistent deficits"—that's the U.S.—"should boost national savings by adopting credible medium-term fiscal targets consistent with sustainable debt levels."

So Mr. Geithner knows that trade surpluses in the end come down to saving and investment. And he knows that in the U.S. people are trying to save right now. Our government is undoing their efforts with massive fiscal deficits. Mr. Geithner recognizes that most of the trade "imbalance" comes down to a big fat fiscal imbalance centered in Washington, D.C. But there's the catch. "Medium term" means "not now" and "not long-run entitlements." "Target" means "promises." Even if a target would make a difference, who believes in targets from our government? We don't know what the rate of taxation will be in three months!

Mr. Geithner goes on to say that "countries running persistent deficits" should "strengthen export performance," but he doesn't say how, or what other "performance" we should weaken to get it. Is this a code word for export subsidies, devaluation and industrial policy, and a plea that the rest of the world should let us get away with it?

His advice to the other G-20 countries, those "with persistent surpluses," is that they "should undertake structural, fiscal, and exchange rate policies to boost domestic sources of growth and support global demand." In particular, "G-20 emerging market countries with significantly undervalued currencies and adequate precautionary reserves''—have you figured out this means China?—"need to allow their exchange rates to adjust fully over time to levels consistent with economic fundamentals."

He argues for a brave new system, coordinated by the IMF, of international discretionary currency interventions: "G-20 advanced countries will work to ensure against excessive volatility and disorderly movements in exchange rates."

How does anyone know if a currency is "undervalued" or not? The economists hidden away in the sub-basements of the IMF may try to decide what currencies "should be" worth across vastly different countries, but this is a hopeless task. Is $2 a day the "right" wage in China, or should that be $2.20 per day because the currency is "undervalued?" Good luck.

Why push China to manipulate its currency upward, but ignore its capital and exchange controls? We should push China to abandon those controls instead. A freely pegged currency is a great idea, especially for a fast-growing, trade-based economy with a weak central bank like China.

What's the right policy toward China? They put a few trillion dollars worth of stuff on boats and sent it to us in exchange for U.S. government bonds. Those bonds lost a lot of value when the dollar fell relative to the euro and other currencies. Then they put more stuff on boats and took in ever more dubious debt in exchange. We're in the process of devaluing again. The Chinese government's accumulation of U.S. debt represents a tragic investment decision, not a currency-manipulation effort. The right policy is flowers and chocolates, or at least a polite thank-you note.

Yet Mr. Geithner thinks that the Chinese somehow hurt us. There is at work here a strange marriage of Keynesianism and mercantilism—the view that U.S. consumers supported the world economy by spending beyond our means, so that other people could have the pleasure of sending things in exchange for pieces of paper.

This is all as fuzzy as it seems. Markets and exchange rates are not always right. But it is a pipe dream that busybodies at the IMF can find "imbalances," properly diagnose "overvalued" exchange rates, then "coordinate" structural, fiscal and exchange rate policies to "facilitate an orderly rebalancing of global demand," especially using "medium-term targets" rather than concrete actions. The German economics minister, Rainer Brüderle, called this "planned economy thinking." He was being generous. Planners have a clearer idea of what they are doing.

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