

Will U.S. Prudence Force China's Hand?



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What kind of economy do we want? Should we remain perennial borrowers, where our life style continues to be dependent on the generosity of foreign lenders? Or has the time come for us to jettison our past shopping habits and instead focus on increasing savings and being more successful selling goods and services abroad?

For more than a decade, the U.S. economy has been caught in a destructive cycle that saw American consumers gobble up underpriced exports from Asia. Indeed, the amount Americans consumers spend in one year is greater than the entire G.D.P. of China, India, Canada and Russia — combined!

The problem wasn't how much we bought. It was how we paid for it.

The problem isn't that we have a hunger for laptops, flat-screen TVs, cars and appliances. It's how we paid for them. Only 65 percent of our shopping bill was paid for out of wages and salaries. The rest was financed by borrowing and through the depletion of our savings. This was a pattern that continued for decades — until finally the borrowing binge helped precipitate the greatest financial crisis since the Great Depression.

But this tells only one side of the story. The other is China's overt effort to keep its currency so cheap that no one could resist buying its products. Such active intervention in the currency markets enabled China to receive massive amounts of dollars earned from trade surpluses, much of which was then plowed back into the U.S. That, in turn, helped keep U.S. interest rates low and fueled even more spending and borrowing by Americans. It was a disastrous cycle that had to end badly. And it did.

Unfortunately, U.S. policymakers have been unable to convince China to allow its currency to float more freely in foreign exchange market. It's hard to believe that China can still get away with fixing the value of its currency now that its become the world's third largest economy with the largest pool of foreign exchange reserves. Nevertheless, while we have been unable to persuade China to act more responsibly, the challenge falls on U.S. consumers to behave more prudently.

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Let's face it: the party is over. If there is one valuable lesson we should take from the last recession it is that Americans must align their spending closer to income growth — and to rely much less on debt to finance their life style. This change in behavior not only makes good sense, the future prosperity of the country depends on it.

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