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The Conscience of a Liberal

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America's Chinese disease (not quite what you think)

Fed chairman are expected to speak in code, so that reading their remarks is a bit like watching the famous scene in *Annie Hall* where the conversation between the lovers is subtitled with what they're really saying. So when [Ben Bernanke](#) says this:

Another set of lessons that Asian economies took from the crisis of the 1990s may be more problematic. Because strong export markets helped Asia recover from that crisis, and because many countries in the region were badly hurt by sharp reversals in capital flows, the crisis strengthened Asia's commitment to export-led growth, backed up with large current account surpluses and mounting foreign exchange reserves. In many respects, that model has served Asia well, contributing to the rapid growth rates in the region over the past decade. In fact, it bears repeating that evidence from the world over shows trade openness to be an important source of economic growth. However, too great a reliance on external demand can also pose problems. In particular, trade surpluses achieved through policies that artificially enhance incentives for domestic saving and the production of export goods distort the mix of domestic industries and the allocation of resources, resulting in an economy that is less able to meet the needs of its own citizens in the longer term.

the subtitle reads

HEY, CHINA, STOP ACCUMULATING DOLLARS — IT'S TIME TO REVALUE YOUR CURRENCY

But does the United States dare put pressure on the Chinese to do that? People constantly say that we can't risk it — that we're dependent on China to keep buying our debt. Yet this is all wrong under current circumstances.

How do I know it's all wrong? Here's one way to think about the issue that I haven't seen anyone else put forth (if they have, I'll be happy to give credit.)

Right now, we're in a situation in which conventional monetary policy is hard up against the zero lower bound; rules of thumb that track past Fed behavior suggest that the short-term interest rate should be -5% or lower. To partially make up for its lack of traction, the Fed is engaged in massive "quantitative easing" — a misleading term, but I guess we're stuck with it. What it basically means is that the Fed is selling Treasury bills or their equivalent (interest-paying excess bank reserves are essentially the same thing), while buying other assets, expanding its balance sheet enormously in the process.

What kinds of other assets? Mortgage-backed securities; securities backed by credit-card

debt; longer-term government debt; etc..

One type of asset the Fed has *not* been buying is foreign short-term securities. But that's not because such purchases would be ineffective. On the contrary, selling domestic short-term debt and buying its foreign-currency counterpart is the essence of a sterilized foreign-exchange-market intervention, which is a time-honored way of gaining a competitive advantage and helping your economy expand.

And some countries have, in fact, made foreign-currency purchases a part of their quantitative easing strategy — [Switzerland in particular](#). The only reason the Fed isn't doing this is that we're a big player, and can't be seen to be pursuing a beggar-thy-neighbor strategy.

But now ask the question: what would the effect be if China decided to sell a chunk of its Treasury bill holdings and put them in other currencies? The answer is that China *would, in effect, be engaging in quantitative easing on behalf of the Fed*. The Chinese would be doing us a favor! (And doing the Europeans and Japanese a lot of harm.)

Conversely, by continuing to buy dollars, the Chinese are in effect undermining part of the Fed's efforts — they're conducting quantitative diseasing, I guess you could say, hence the title of this post.

The point is that right now the United States has nothing to fear from Chinese threats to diversify out of the dollar. On the contrary, if the Chinese do decide to start selling dollars, Tim Geithner and Ben Bernanke should send them a nice thank-you note.