

Posted on Tue, May. 17, 2005

U.S. warns China to overhaul currency

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WASHINGTON - The Bush administration warned China on Tuesday that it could be cited as a currency manipulator and face economic sanctions unless it moves swiftly to overhaul its currency system.

The administration has been prodding China in earnest over the last two years to stop linking its currency, the yuan, to the U.S. dollar. Manufacturers and other critics, including Democratic and Republican lawmakers in Congress, contend that China's currency system puts U.S. companies at a big competitive disadvantage and has contributed to the loss of U.S. factory jobs.

On Wall Street, stocks vaulted higher after the Treasury Department announcement. The Dow Jones industrials gained 79.59 points to close at 10,331.88.

In China, central bank governor Zhou Xiaochuan said no one should expect quick action. "Our measures will only come out after we have done a good feasibility study," he said.

The department issued the warning as part of its twice-a-year report to Congress. It stopped short of finding that China - or any other major trading partner of the United States - was engaging in unfair currency practices.

Separately, President Bush said Tuesday that China was not living up to the market-opening promises it made to join the World Trade Organization in late 2001. He urged the country to stop piracy of U.S. intellectual property and lift barriers that keep American goods and services out.

At a ceremonial White House swearing-in for U.S. Trade Representative Rob Portman - who was officially sworn in last month - Bush pointedly said it was in China's interest to abide by WTO rules.

"America is a nation founded on the idea of open exchange, and free and fair trade is a win-win for all sides," he said.

The administration said China could be branded a manipulator of currency if the country doesn't switch soon to a flexible exchange system - something advocated not only by the United States but also by other economic powers.

A 1988 law requires the Treasury Department to analyze countries' exchange rate policies and determine whether manipulation to gain unfair trade advantages is occurring. The law has economic sanctions that can be imposed on countries found in violation.

"If current trends continue without substantial alteration, China's policies will likely meet the statute's technical requirements for designation," the department's report said.

American manufacturers say China's system has undervalued the yuan by as much as 40 percent. The weaker yuan makes Chinese goods cheaper in the United States and American products more expensive in China.

The report called China's currency policies "highly distortionary" - posing a risk to, among other things, China's trading partners and global economic growth.

The administration said it would monitor China's progress on moving toward a flexible exchange system

"very closely over the next six months" in advance of the Treasury's next currency report that will be sent to Congress later this year.

Treasury Secretary John Snow, speaking to reporters, wouldn't be pinned down on the timing of a possible designation of China should the country not move ahead as the United States wants it to. He also wouldn't detail how high he would like to see China's currency to rise.

Snow did say, "It should be a real step - it should be something the world can see and know that China means business."

American manufacturers have pushed for China to be branded a currency manipulator, a designation that could ultimately lead to economic sanctions against that country.

Although National Association of Manufacturers President John Engler was disappointed that this finding wasn't made, he welcomed the administration's tough tone. "The language is about as hard-hitting as it can be without actually citing China," he said.

The administration has come under increasing pressure as America's trade deficit with China has soared to record levels, hitting \$162 billion last year, the biggest deficit ever recorded with any country.

Until recently, the administration had insisted its efforts at financial diplomacy were working to get China to allow its currency's value to be set by currency markets rather than controlled by the government.

However, last month, the Senate by a lopsided 67-33 vote cleared a procedural hurdle that sets the stage for a vote on legislation that would impose across-the-board 27.5 percent penalty tariffs on all Chinese imports into the country unless China changes its currency system.

Fearing the erection of protectionist barriers, the administration then began taking a tougher approach in its public comments.

Federal Reserve Chairman Alan Greenspan also has said the time for China to act is now.

For their part, the Chinese still insist they need more time to shore up their banking system so it can withstand the volatility that a flexible currency would introduce.

Central bank governor Zhou said Tuesday that China would take its time in preparing to loosen controls on its currency, dismissing speculation that a revaluation of the yuan could come soon.

"We are taking time to do the preparation work. We will not come out with any measures hastily," Zhou said during a conference in Beijing.

AP Economics Writer Martin Crutsinger and AP Business Writer Elaine Kurtenbach contributed to this report

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