Opening Statement

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Committee on Financial Services

Subcommittee on Domestic and International Monetary Policy, Trade, and Technology

"China's Exchange Rate Regime and Its Effects on the U.S. Economy"
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Good afternoon. I would like to thank Chairman Peter King for convening today's hearing on an important issue which is assuming a growing importance in our national economic policy. This is an excellent use of the Subcommittee's jurisdiction not just over international monetary policy matters but also economic growth and stabilization. I particularly commend Mr. King for his foresight since he has been looking at this issue throughout the year, long before it became fashionable to focus on the relationship between the valuation of China's currency and the U.S. economy.

The strength and flexibility of our country's economy derived in no small measure from our commitment and leadership to free and open capital markets. We encourage countries, both through negotiation and example, to leave the seeming security of capital controls and other market restrictions. Embracing free markets means providing freedom for capital to find its most productive home and for markets in goods and services to grow beyond national borders.

A commitment to free markets also implies a corollary commitment to accept that perhaps old ways of doing business are more productive if they are done elsewhere. This is what economists refer to as "creative destruction." Permitting capital to leave a country should create a significant incentive for people and industries to innovate so that they can become more competitive in the marketplace. I also believe that free movement of capital necessarily also creates the environment for free movement of ideas that can provide the foundation for creating or enhancing democratic processes.

This mutually beneficial arrangement can only work, however, if both goods and capital can flow freely through economies. Liberalizing one sector (e.g., goods) while keeping a tight rein on another sector (e.g., capital) may feel good and may provide security against messy volatility in the short-run. However, this policy can create serious imbalances in the economy choosing this policy and it can inhibit fair competition.

That is why today's hearing is so important. China is the world's most populous country. It is becoming one of the United States' most important trading partners. It has recently served as a source of strength in Asia, as well as an engine of economic growth globally. Many people, including me, welcome its efforts to become more integrated in the global economy and seek to encourage further economic liberalization. U.S. companies and consumers benefit from a strong and growing China, but only if that growth is based on a fair system.

At the same time, China's vibrant economic growth and potential for 21st Century success should lead it to adopt 21st Century exchange rate policies as well. If China is going to be serious about its WTO commitments, it must also recognize that fair competition requires market-determined exchange rates in addition to opening its markets to foreign companies.

It is true that such large changes cannot occur overnight, especially in a command economy. It is also true that a financial system must be strong and resilient in order to absorb the kind of capital market volatility that accompanies floating exchange rates. Finally, it is true that China's fragile banking system needs to be strengthened if a floating rate system is to be launched successfully. These facts should underscore the importance of China moving clearly and unambiguously towards banking sector reform. They cannot serve as an excuse for delaying these necessary reforms.

I commend Secretary Snow for his efforts in Asia and the G-7 in this area. Secretary Snow's leadership demonstrates the U.S. commitment to free markets and fairly determined exchange rates. I look forward to Undersecretary Taylor's update on the progress of these initiatives.

Of course, exchange rates are only part of the story. Our dynamic economy for some time now has been undergoing a dramatic shift towards service sector jobs and away from manufacturing jobs. It is unclear how the Chinese exchange rate regime contributes to, or accelerates, this trend. However, the trend should not be confused with the notion that the U.S. economy will someday outsource all production of physical goods. We should not accept that possibly unfair competition will require hard-working Americans doing a good job to be unemployed.

I therefore commend the Administration's recognition that it will take more than just international economic diplomacy to foster free and fair markets. The manufacturing sector in this country is a significant source of innovation, patent development, and economic growth. We cannot permit unfair competition to undercut this important activity. The Commerce Department recognizes this and I look forward to Undersecretary Aldonas' testimony describing how the Commerce Department is protecting American manufacturing interests.

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