United States Senate
Committee on Finance

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Opening Statement of Senator Chuck Grassley
Finance Committee Hearing
"Risks and Reform: The Role of Currency in the U.S.-China Relationship"
Wednesday, March 28, 2007

I want to thank the Chairman for convening this important hearing on the role of currency in our economic relationship with China. And, I want to thank our witnesses for their participation. This hearing is part of a process that I agreed to last September with Chairman Baucus, Senator Graham, and Senator Schumer. After working on separate tracks in the last Congress, we agreed to try and work together this year to develop new legislation to address currency exchange rates. The only pre-condition that we set was that any new legislation would have to be consistent with the obligations of the United States as a member of the World Trade Organization.

I look forward to today's testimony and to any written comments that may also be submitted to the Committee. Such testimony and commentary will help inform our joint effort. I'm anxious to get started, because two things are apparent to me. First, there's a significant issue with respect to the artificial undervaluation of China's currency relative to the U.S. dollar. And second, our laws pertaining to oversight of currency exchange rates are in need of overhaul to better address the economic landscape of the 21st century.

With respect to the first point, why should we be concerned about China's undervalued currency? I'm concerned because of the risks and distortions that ensue. Most economists would say that in response to mounting bilateral and global trade surpluses, the Chinese currency should appreciate. But that's not happening. Instead, China has engaged in large-scale intervention to restrict appreciation of its currency. I look forward to hearing what our witnesses think about the risks and distortions associated with such intervention. For example, to what extent does it create an incentive within China to over-invest in export-related production? To what extent does it make U.S. products and exports less competitive? Does it create the potential for higher inflation in China? Does it create an incentive for speculative investment and increase the risk of asset price bubbles in China? Over time, does it leave China more vulnerable to domestic and/or external economic shocks? Does it leave the United States more vulnerable to a sharp, disruptive movement in the value of the U.S. dollar? From a longer term perspective, to what extent does it impede necessary reform of China's financial services sector? Those are some of the points I'm interested in exploring as we engage in this fact-finding exercise.

Now, I don't want to leave the impression that the issues lie entirely at China's doorstep. During yesterday's hearing on our economic relations with China, I noted that our trade deficit with China is very much a function of U.S. consumption, because we're producing more and exporting more than ever before. When we purchase imports we provide the foreign reserves that allow China to intervene in currency markets. In 2006, U.S. consumption of consumer goods accounted for almost 40 percent of our total trade deficit in goods. So there's clearly room for U.S. consumers to purchase less and save more.

At the same time, I think we should be able to rely on market forces to balance out the pressures of fluctuating international trade flows and differential interest rates on major currencies. China is a major beneficiary of our open system of international trade, so they should be no different. That's not to say that China should act overnight. But I do think the Chinese government can, and should, be moving more quickly in that direction. It's in everyone's best interest that they do.

As for my second point, I note that our currency oversight laws date to 1988. Back then, our primary concern was with respect to the Japanese yen. Today it's with respect to China. Tomorrow, who knows? We need to overhaul our laws so that the Treasury Department is generally empowered to respond more forcefully to significant currency imbalances. So, I intend to work on legislation that is not specific to any particular country or currency. It'll be broader than that.

Finally, I invite comments from our witnesses with respect to the role that the International Monetary Fund can or should play in future oversight of currency exchange rates. I would further ask, to what extent is the IMF equipped to handle that role? Is reform of the IMF needed to ensure that it remains relevant to the needs of the global economy in the 21st century? And if so, how? These are important questions that also need to be addressed as we move forward in developing new legislation.