China follows many practices that tilt the playing field in its favor, which the U.S. should rightly seek to change. Exchange rate policy no longer belongs on the list. Rather, it is the U.S. approach to China’s exchange rate policy that lags reality. Offering to recognize China’s shifts in policy presents a valuable bargaining chip in negotiations with China on more pressing matters and can institutionalize China’s role as a custodian of global stability, a win–win arrangement.

China has actively prevented yuan depreciation for over two years, which promotes rebalancing globally and with the United States. China’s government aims to improve financial stability, for instance, in better communication strategies that calm markets. Chinese officials now regularly repeat that they have no intention of using exchange rate depreciation as a policy tool.

China could hardly change their exchange rate policy in a more favorable direction, so punishing China for currency manipulation could not possibly induce a better outcome. Countries that truly deserve scrutiny like Taiwan and sometimes Korea would see that adopting good behavior does not beget U.S. appreciation.

The shift in China’s exchange rate policy ties in with Chinese President Xi Jinping’s goal to achieve China’s potential as a global power and, more specifically, for the yuan to serve as a reserve currency. If the U.S. offers to support these goals, it can change the dynamic of cooperation in the area of global economic governance, which is a top priority for restoring a balanced trade relationship.

An even stronger offer would be to create a new G–7-style grouping that includes China. This should be a smaller high–table grouping of finance ministers and central banks focused on the international financial system. By including China, this arrangement would more effectively promote good global governance and also help institutionalize the shift in China’s exchange rate policy. China’s rising economic power necessitates its inclusion, and the G–7 structure has grown outdated in ways that extend beyond China’s absence.

This policy would represent a significant gesture by the U.S. to China, and therefore provide leverage on other issues. At the beginning of a new administration, this could usefully set a tone of cooperation. Where to apply that leverage may depend on evolving priorities.

Despite the perception that this proposal may represent a gift to China, in reality it gives very little. The rise of China as an economic power will eventually require from the U.S. all of the measures described in this brief. The question is only one of timing. The U.S. should accelerate the timing so that our policy shift looks magnanimous rather than grudging. By shifting now the U.S. does so on its own terms and gains more in return.

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**BACKGROUND**

China has made strong efforts to prevent a weaker yuan. China’s foreign exchange reserves have fallen by almost US$1 trillion since July 2014. Despite this, the yuan has depreciated almost 8% against the dollar over that period, 3% of which came across two days in August 2015. Depreciation
The G-7 is an artifact of an earlier age before the advent of the euro and before China’s rise. The G-20 has rightly taken the G-7’s place as the preeminent grouping for coordinating international policies at the leaders level. But for matters of international financial policy—to calm markets in times of crisis or to maintain discipline on the “rules of the game”—it is far too large and unwieldy.

A grouping with the U.S., Eurozone, Japan, China, and the UK would suffice to cover the essential markets and currencies. China is moving in the direction of a like-minded shepherd of the international financial system, and its inclusion would provide further momentum. The G-7 was essential to corralling Japan into a policy against depreciation of the yen after the election of Prime Minister Shinzo Abe in 2014, and its stance against competitive depreciation provided a platform that China adopted in the G-20. A new grouping could continue this helpful role more effectively and efficiently in the future.

ENDNOTES

1. A portion of the decline may derive from valuation changes as non-dollar reserves fell in dollar terms.

