Why China Won't Revalue

Peter Morici

An undervalued yuan offers Beijing great advantages but imposes significant costs on the U.S. economy. That is not likely to change anytime soon, because those costs are not apparent to many Americans feasting on cheap imports, and President Bush and the Congress lack the courage to act effectively.

In a nutshell, Beijing prints yuans and buys dollars in currency markets to keep down the dollar exchange rate for the yuan. This makes Chinese goods cheap in U.S. stores and U.S. goods expensive in China.

With the dollars obtained, Beijing purchases U.S. securities, which keeps U.S. interest rates down and recycles dollars into the hands of U.S. consumers to buy cheap Chinese manufactures.

As Federal Reserve Chairman Ben Bernanke observes, this creates a subsidy on Chinese exports, which by my math comes to at least 25 percent. It also imposes a hidden tax on U.S products sold in China.

China supplements currency shenanigans with tax rebates on exports and complex restrictions on imports and foreign investment, which effectively require GM, Intel and others to produce in China to sell there.

China exports, not merely goods making abundant use of inexpensive labor, but also technology-intensive products, where China has few natural advantages. That's how China runs up a $230 billion annual trade surplus with the United States.

The Chinese economy grows about 10 percent a year. This permits the Communist Party to keep an increasingly sophisticated population focused on rising living standards and distracted from corruption, hazardous environmental conditions, and the absence of democratic reforms, which would remove party officials and their families from opportunities to amass great wealth.

Other Asian governments follow variants of China's currency policies, and together their purchases of U.S. debt help Americans to consume 5 to 6 percent more than they produce and enjoy low prices at the Wal-Mart. Those Americans not competing directly with Asian imports feel richer and are disinclined to support strong action against China to effect change.

Multinational companies, like Caterpillar, may earn less manufacturing in the United States, but they are doing very well in China. As their investments in China grow, they have a deepening stake in Chinese protectionism, and outwardly resist U.S. measures that could impel China to alter its policies.

However, China's policies are driving out of business many U.S. manufacturers who would otherwise be competitive but for subsidized competition from China and elsewhere. Thanks to currency manipulation, two million U.S. manufacturing jobs have been lost, and U.S. GDP is about $250 billion dollars lower than it would otherwise be. Also, potential GDP growth is a full percentage point lower than the four percent a year it could be. The resulting costs far exceed any benefits Americans receive from cheap coffee tables and TV sets at Wal-Mart.

The essential political problem in the United States is that immediate and visible costs imposed by Chinese mercantilism are most concentrated on perhaps less than 25 percent of the population, while the benefits, though smaller in total, are broadly available to most voters.

In Congress, many members want to appear to be doing something about the problem, to appease constituents directly harmed by China's policies, but won't support measures that strike at the heart of Chinese mercantilism. In particular, the Democratic majorities in the Senate and House have refused to embrace legislation that would require the Department of Commerce to apply non-protectionist countervailing duties on imports, which would merely offset the currency subsidies Ben Bernanke has identified, when those imports injure U.S. businesses and result in job losses.

The White House outwardly opposes any such policy, and promises that diplomacy will yield positive results after years of failure. It has obtained changes in International Monetary Fund rules to require that institution to further investigate Chinese currency practices. Not to be outdone, the House Ways and Means Committee Chairman Charles Rangel has asked the U.S. International Trade Commission to investigate the trade deficit with China.

The time for study and diplomacy has long passed. President Bush needs to recognize China's subsidies for what they are. He has the authority, without any new legislation, to empower and require the Commerce Department to apply countervailing duties to Chinese currency subsidies, when they harm U.S. industries. That could be done in ways that fully comply with World Trade Organization obligations.

President Bush should explain to the American people why that is the right thing to do it and then do it. If he doesn't, Congress should compel it.

Until the Americans move, China won't revalue.

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