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China Currency Bill Will Destroy U.S. Jobs, Not Create Them

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Dan Ikenson

Supporters of the China currency legislation fall into two camps. There are those frustrated by the fact that the Chinese government no longer asks “How high?” when U.S. policymakers shout “jump!” For this camp, the legislation is a therapeutic exercise in venting – the legislative equivalent of road rage. It might make trade relations and the economy worse, but boy does teeing off on those Chinese upstarts sure feel good. This is hardly the recipe for smart policy.

The other camp of supporters believes that the Currency Exchange Rate Oversight Reform Act of 2011 will, in fact, produce a positive outcome. This camp accepts three sequential premises (whether they realize it or not): (1) the legislation under consideration will compel China toward faster yuan appreciation; (2) a rising yuan will reduce the bilateral trade deficit, and; (3) a smaller bilateral trade deficit with lead to U.S. job creation. In short, this camp sees the legislation as a jobs bill.

But the likelihood of that sequence of events playing out is remote. Indeed, the ensuing analysis finds the legislation under consideration to be at least 300 percent more likely (or, if you prefer, four times as likely) to destroy U.S. jobs than it is to create them.

Let’s start by evaluating the second premise. What is the likelihood that a rising yuan will reduce the bilateral trade deficit? Well, from 1997 to July 2005, the yuan was pegged at a dollar value of about 12.08 cents. Between July 2005 and July 2008, the value of the yuan in dollar terms increased by 21 percent to 14.64 cents. Surely, proponents of the legislation would want to cite the dramatic reduction in the bilateral trade deficit that followed this period of yuan appreciation to support their position. Alas, during that period, the bilateral trade deficit **increased** by 33 percent from $202 billion to $268 billion. Since June 2010, the Yuan has appreciated by another 7 percent against the dollar. And the bilateral trade deficit? It’s on target for to be one-third larger in 2011 than it was last year.

So, recent evidence doesn’t support the premise of an inverse relationship between the value of the yuan and the size of bilateral U.S. deficit. Instead, both have increased

simultaneously. Yet proponents of the law insist that a rising yuan will lead to a reduced bilateral deficit. Where is any evidence of this?

The truth is that the relationship between currency values and final goods trade flows has been complicated by the fact of intermediate goods trade. Globalization and the proliferation of transnational supply chains—which means far more intermediate goods trade than in the past—has dulled the impact of currency values on final goods trade.

Only about half of the value of Chinese exports to the United States is actually Chinese value. The other half is value from components produced in other countries. When the yuan appreciates, those imported intermediate goods become less expensive to Chinese producers, who can then reduce their prices for export and preserve their market shares abroad. Despite the 21 percent appreciation of the yuan between 2005 and 2008, U.S. imports increased by 39 percent.

(This analysis goes into detail about the points raised in the previous three paragraphs.)

Though recent history suggests the probability is very much lower, let's give currency legislation proponents the benefit of the doubt and assume a 50 percent chance that future yuan appreciation will reduce the bilateral trade deficit.

The next necessary condition in the sequence is that the smaller bilateral trade deficit creates U.S. jobs. That is the premise of the oft-cited study from the Economic Policy Institute that claims the bilateral deficit with China cost 2.8 million U.S. jobs between 2001 and 2010. The study's author asserts: "Increases in U.S. exports tend to create jobs in the United States, and increases in imports tend to lead to job loss. Thus, a growing trade deficit signifies growing job loss."

Well, that assertion is demonstrably false – as evidenced by the chart in this post. Instead of an inverse relationship between the bilateral trade deficit and jobs, there appears to be a positive relationship. Just have a look: when the deficit increases, U.S. employment rises; when the deficit shrinks, U.S. employment declines.

In the quarter century between 1983 and 2007, as real GDP more than doubled and the real value of U.S. trade increased five-fold and the U.S. trade deficit increased from $73 billion to $655 billion, the U.S. economy created 46 million net new jobs, or 1.84 million net new jobs per year. And as economic growth came to a halt and then turned negative during the recent recession, trade contracted by 12 percent, the deficit fell from $655 billion in 2007 to $363 billion in 2009, and the economy shed over six million jobs. This experience is diametrically opposite the contention of EPI.

Despite ample doubt that a shrinking trade deficit leads to U.S. job creation, let's assume—again to err on the side of currency legislation proponents—that the likelihood of that unlikely occurrence is 50 percent.

Now, let's go back and evaluate the first premise of this chain of premises – that the legislation will be an effective prod that compels the Chinese government to allow faster appreciation. Remember the logic of the second camp: the legislation compels faster yuan appreciation, which reduces the bilateral deficit, which spurs U.S. job growth.

It is highly unlikely that the legislation will prod China into allowing faster appreciation. If anything, it could prompt China to slow or stop yuan appreciation to make a strong political statement that it will not be bullied – particularly not by a government that doesn't have its economic house in order. But it is more likely that China would continue to allow appreciation at a pace it deems appropriate. After all, the government favors currency appreciation as an instrument to deal with domestic economic concerns, like rising inflation.

Realistically, China could simply ignore the law, stick with its own timetable for currency appreciation, and contest at the WTO any U.S. actions that come to bear — though any such actions would be at least two years away given the action-triggers and admininistrative timelines of the law. But again, let's indulge the legislation's proponents and estimate that there is a 50 percent probability that passage of the legislation will induce China not to accelerate appreciation of the yuan.

Now let's do the math. If there's a 50 percent chance that the legislation compels China to allow faster appreciation of the yuan and a 50 percent chance that yuan appreciation reduces the bilateral trade deficit and a 50 percent chance that a smaller bilateral trade deficit leads to job creation, then—under these very generous assumptions—the legislation has a 12.5% likelihood of creating U.S. jobs. (Gives a pretty good indication of what Harry Reid thinks of President Obama's jobs bill that he would keep it sidelined in favor of a bill that has a one-in-eight chance of creating jobs).

Compare that probability to the likelihood that the Chinese government would react to passage of this legislation with retaliatory measures that would make life more difficult for U.S. exporters or U.S. companies doing business in China. What would that do for U.S. jobs? Recall that China imposed trade remedy duties on chicken and auto parts in the immediate aftermath of the U.S. imposition of duties on Chinese tires in 2009 (i.e., China retaliated). Several agencies within the Chinese government has even stated that this currency legislation likely would lead to a trade war.

If we estimate the likelihood of Chinese retaliation, which would adversely impact U.S. employment, to be 50 percent (another conservative assumption given past reactions and current statements), it is fair to conclude that the Currency Exchange Rate Oversight Reform Act of 2011 is a job-destruction bill. With a 300 percent greater likelihood of destroying rather than creating jobs, the laws cosponsors and supporters have not done the proper analysis. But why would they anyway? This whole enterprise is just another Washington diversion from the real solutions at the American public's expense.