Deal with the Dragon

Trade with the Chinese is good for us, them, and the world

BY DANIEL GRISWOLD

LAST fall, Democrats tried desperately to turn voters' anxieties about trade with China into a winning issue on Election Day. Yet while Americans tell pollsters they worry about losing jobs to China, a majority who voted in November failed to take the bait.

Across the country, but especially in the industrial heartland, candidates who refused to make China a bogeyman were accused of shipping American jobs and industry to our Communist rival across the Pacific. In one TV ad in Pennsylvania, Democratic Senate candidate Joe Sestak said his pro-trade Republican opponent, Pat Toomey, "ought to run for Senate in China."

Instead, Toomey and a flock of other pro-trade Republicans are now safely sworn in as members of the new Congress. Early signs point to a more business-friendly relationship with China. Republican House leaders announced early in the new Congress that legislation targeting China for its currency policies would not be on the trade agenda. They concluded, wisely, that the U.S. government faces many more urgent challenges.

Although the U.S.-China trade relationship is complex, it is fundamentally beneficial for both countries, for the same reasons that expanding trade has served America's interests throughout the post-WWII period. Trade with China, like trade with the rest of the world, enlarges markets for U.S. companies and blesses American consumers with more competition, innovation, and lower prices, while promoting peace and spreading American influence and values abroad.

Politicians obsess over exports, while forgetting that all their constituents benefit from imports. Of the $365 billion worth of goods Americans imported from China in 2010, more than three quarters were consumer products that make our lives better every day at home and the office. Top imports from China are clothing, shoes, toys, household appliances, computers, and other consumer electronics.

Those goods are especially important to working-class, Walmart-shopping families that spend a higher share of their income on the affordable, non-durable consumer items we import from China. A 2008 University of Chicago study by Christian Broda and John Romalis found that imports from China have slowed the rate of increase in the prices of goods likely to be purchased by the poor. Politicians who call for higher tariffs on imports from China are aiming straight for the pocketbooks of the poor and middle class.

For American companies and their workers, China remains the fastest-growing major market for U.S. exports. From somewhere back in the pack 20 years ago, China is now the number-three buyer of U.S. exports, behind only our NAFTA partners, Canada and Mexico. Exports to China in 2010 jumped 30 percent from the year before, increasing far faster than exports to the rest of the world. Soybeans and copper are among the top U.S. exports, but most of the things we sell to China are high-end manufactured products, led by chemicals, plastics and other industrial supplies, industrial machinery, computers and semiconductors, and civilian aircraft.

Selling in China is not just a Fortune 500 phenomenon. More than a third of our exports to China are supplied by small and medium-sized enterprises (SMEs) employing 500 or fewer workers. Talk to the people near you on a flight to China and you are likely to meet a sales rep or executive for one of the 27,000 American SMEs now selling their wares in China's rapidly expanding market.

When the Chinese are not buying U.S. goods with the dollars they earn, they buy U.S. Treasury bills. Critics put a sinister spin on the federal government's growing indebtedness to China, but it's a simple fact that if the U.S. government did not borrow from Chinese savers, it would need to borrow from some other country. Our own level of domestic savings is too low to fund both the yawning fiscal deficit and the investment opportunities created in the private sector.

While trillion-dollar deficits are terrible, they are not China's fault, but that of our profligate politicians in Washington. If we didn't borrow this money from China, Japan, and other net savers, long-term U.S. interest rates would be almost a full percentage point higher, according to a Federal Reserve study, and critical investment in our economy would be crowded out. The inflow of capital from China stimulates the U.S. economy without stoking inflation or encouraging subprime lending.

Critics dismiss all those benefits by blaming trade with China for costing America jobs and security. On February 10 more than 100 House members, a quarter of them Republicans, introduced the Currency Reform for Fair Trade Act of 2011, which would make it easier to slap anti-dumping and anti-subsidy tariffs on imports from China because of its allegedly undervalued currency. In hyperbole typical of the China debate, cosponsor Jim McDermott (D., Wash.) said at the bill's unveiling, "It's as though [the Chinese] have a boot on the neck of the working man in this country."

To be sure, China's central bank tightly manages the value of its currency, but so do those of many other developing countries. And China has taken tangible steps in recent years to make its currency more flexible, allowing the renminbi to gradually rise by about 25 percent against the dollar since 2005. When combined with rising inflation within China, the real exchange rate of the renminbi has appreciated by 50 percent. That's more than the adjustment demanded by the likes of Sens. Charles Schumer (D., N.Y.) and Lindsey Graham (R., S.C.) when they threatened in a 2005 bill to impose a 27.5 percent tariff on all imports from China. Yet the critics keep chanting the same mantra.

A small slice of U.S. industries and workers compete head to head with producers in China, but the vast majority do not. Much of what we import from China consists of goods like T-shirts, sneakers, and plastic toys—things that we were importing from other countries long before China's rise as a supplier. Those industries have been shedding jobs and shifting production offshore for decades.

President Obama's September 2009 tariff on Chinese tires shows the futility of trying to save jobs by curbing Chinese imports. As a sop to his union base, the

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president imposed a 35 percent duty on low-end tires made in China. Sure enough, imports from China dropped in 2010, but an analysis by the U.S.-China Business Council found that the tariff did not boost domestic tire production; instead, the gap was more than filled by surging imports from other low-cost producers. Meanwhile, domestic prices for cheaper brands of tires rose 10 to 20 percent, hitting low-income drivers the hardest.

Politicians fixate on the big bilateral trade deficit we run with China—a record $273 billion in 2010. But the proliferation of complex supply chains has rendered bilateral trade numbers almost meaningless. Just look at an iPhone. While it is technically "Made in China," a recent study by the Asian Development Bank Institute found that less than 4 percent of the cost of manufacturing an iPhone represents value added in China. The screen comes from Japan, the processor from Korea, the GPS system from Germany, and memory chips and network components from the United States. Of the $179 it costs to actually make an iPhone, the study found that only $6.50 is spent on the labor to assemble it in China. Yet the full price of the iPhone hardware is counted in our bilateral trade deficit with China.

As with tires and iPhones, the rising tide of imports from China in recent years has not replaced U.S. production so much as imports that used to come from China's neighbors. Since 1990, the share of U.S. imports coming from China has rocketed from 3 to 17 percent, while the share coming from the more developed economies around China, such as Japan, South Korea, Taiwan, Hong Kong, and Malaysia, has plummeted from 31 to 13 percent.

Moreover, the historic market reforms and trade liberalization the Chinese government began in 1978 represent the greatest anti-poverty program in the history of mankind. Between 1981 and 2005, according to the World Bank, the number of people in China living in absolute poverty, defined as an income of $1.25 a day or less, fell by an amazing 628 million, and that number is expected to fall another 138 million by 2015.

As the Chinese middle class expands, it becomes not only a bigger market for U.S. goods and services, but also more fertile soil for political and civil freedoms. Although China remains an oppressive, authoritarian one-party state, the Chinese people have more breathing room to run their daily lives than at any time since the Communist takeover in 1949. Millions of Chinese are traveling abroad each year. An educated, tech-savvy, property-owning middle class is beginning to assert itself on issues such as land use and corruption. And when doors open to the movement of goods, people and ideas invariably follow. Today Hayek and the Bible are being printed and distributed legally in China.

China hawks warn that the nation's rising wealth is funding a military machine that will soon challenge American influence in the region. In fact, while China's military is growing stronger, the country's deepening economic ties to the United States and to its neighbors are helping to keep the peace in the East Pacific. War would cost China not only blood and treasure, but also vital markets and investment. If we could somehow roll back China's economic gains, it would probably make the Middle Kingdom more dangerous, not less.

The record of forcing regime change through trade sanctions is checkered. It hasn't worked with Burma and Cuba, for example. The more promising path is economic reform paving the way for political change, as we've witnessed in South Korea, Taiwan, and Chile. In similar fashion, our expanding commercial relationship with China is reshaping that nation, in a way that marks another milestone in the gradual, sometimes halting global advance of property rights, free and open markets, and the development of a civil society independent of government domination. **NR**

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The Castros' American Prisoner

A tale of U.S.-Cuban relations

BY JAY NORDLINGER

The case of Alan P. Gross is an extraordinary one, and an outrageous one. If you have not heard of Gross, you can be forgiven: His case has received relatively little press. He is a veteran American aid worker, who has concentrated on getting Internet access to those without it. He has done this all over the world. Since Dec. 3, 2009, he has been a prisoner, or a hostage, in the Castros' Cuba. On March 12, 2011, a Cuban court (such as they are) sentenced him to 15 years in prison. His case tells us a lot about relations between Cuba and the United States, and in particular about relations between Cuba and the Obama administration. And what it tells us is not heartening.

Gross works, or worked, for a company called Development Alternatives Inc., in Bethesda, Md. DAI is a contractor of the U.S. Agency for International Development. The company was tasked with distributing aid to civil-society groups in Cuba. This was, in short, "democracy building." Gross made five trips to the island. Specifically, he was working with the Jewish community there, only about 1,500 strong (or weak). With communications equipment, including satellite phones and computers, he was helping them connect to the outside world. Cuba is one of the darkest places on earth for the Internet. The dictatorship greatly fears technology in the hands of citizens, no matter how innocuous those citizens are.

At the end of that fifth visit, Gross was in the airport, ready to depart Cuba. It was then that the authorities nabbed him. They threw him in prison, where he sat for 14 months, without trial, even without charge. The Cubans were pretending that he was some sort of spy. This was laughable, to everyone familiar with Gross and his work. He spoke no Spanish, or broken Spanish. And he was quite obvious—tragically obvious, or indiscreet—in what