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Bipartisan Punishment of China Would Destroy U.S. Jobs

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Last week, 16 Republican senators joined 46 Democrats to pass legislation that threatens punitive duties on Chinese imports in the absence of more rapid appreciation of China's currency. Bipartisan support for a similar bill in the House has Speaker John Boehner under pressure to allow a floor vote. If this bill becomes law, U.S. job loss is far more likely than job creation to result.

Some policy makers see China's rise as impairing America's capacity to fulfill its economic and geopolitical objectives. For them, the fact that the Chinese government does not prioritize the demands of U.S. politicians is enough justification for action. The currency bill is a therapeutic exercise in venting—the legislative equivalent of road rage. The fact that it might make trade relations and the economy worse is but a small price to pay.

Others see the legislation as a useful diversion. With public approval ratings of about 14%, an embattled Congress is looking for plausible scapegoats for the dismal state of U.S. economic affairs. Thanks mostly to media-driven hype about China's inexorable rise at U.S.expense, Americans fear China almost as much as they loathe Congress. A vote to reclaim American jobs allegedly "stolen" by China enables politicians to feign noble efforts.

Still, there are less cynical—but no less misguided—policy makers who see the currency legislation as a jobs bill. They believe the legislation will compel China toward faster yuan appreciation, which will reduce the bilateral trade deficit, which will create U.S. jobs. But the likelihood of any of those events—let alone the sequence—is remote.

First, the legislation is unlikely to prod China into accelerating yuan appreciation. Threats from the United States are more likely to prompt China to do the opposite to project its sovereignty and strength. But the Chinese government is most likely to heed its own analysis that continued gradual appreciation is the safest path to curbing inflation without risking economic growth.

Second, the presumption of an inverse relationship between the value of the yuan and the bilateral deficit is belied by recent history. Globalization and the proliferation of transnational supply chains—which means far more intermediate goods trade than in the past—have dulled the impact of currency values on final goods trade flows. Only about half of the value of Chinese exports to the United States is actually Chinese value. The other half comes from components produced in other countries that are processed or assembled in China. Yuan appreciation reduces the price of intermediate goods to Chinese producers and assemblers, who can then reduce their prices for export to preserve their market shares abroad.

Between July 2005 and July 2008, the value of the yuan increased by 21% against the dollar. But the bilateral deficit increased by 33%, from $202 billion to $268 billion. Since June 2010, the yuan has appreciated by another 7% against the dollar. And the bilateral trade deficit? It's on target to expand by one-third in 2011.

Third, the bill's supporters, citing highly questionable findings from a union-funded study, contend that a smaller deficit will spark U.S. job creation. However, over the past three decades, there has been a positive relation between the trade deficit and jobs. In years when the deficit increases, U.S. employment rises. In years of shrinking deficits, U.S. employment declines. Between 1983 and 2007, the U.S. trade deficit increased from $73 billion to $655 billion. During that period, real gross domestic product (GDP) more than doubled, and the U.S. economy created 46 million net new jobs—1.84 million net new jobs per year. As economic growth turned negative during the recent recession, the trade deficit fell from $655 billion in 2007 to $363 billion in 2009, and the economy shed more than 6 million jobs.

Accordingly, the probability that the legislation will result in faster yuan appreciation, or that faster yuan appreciation will reduce the bilateral deficit, or that a reduced deficit will create U.S. jobs, are each small. But even if each probability were as high as 50%, the collective probability that the legislation would lead to job creation amounts to just 12.5% (50% chance that the legislation leads to faster appreciation, 50% chance that faster appreciation reduces the deficit, 50% chance that a lower deficit creates jobs).

Now consider the probability that China would impose job-killing retaliatory duties on U.S. exports. First, the Chinese government has stated on several occasions that the currency legislation would incite a trade war. Second, in response to U.S. duties on Chinese tires in 2009, the Chinese government imposed duties on U.S. chicken and auto parts, which reduced sales and employment in those U.S.industries. Given its words and deeds, it is reasonable to assume at least a 50% chance that the Chinese government would impose retaliation against U.S. exports, which would result in U.S. job loss.

With a 50% chance that the legislation destroys jobs and a 12.5% chance that it creates jobs, the currency legislation is employment roulette, only the odds are stacked 4-to-1 against a favorable outcome. No wonder the American public holds Congress in such low regard.