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THE EDITORS

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Don't Blame China, Blame Congress

Most members of Congress appear to know two things about China's relationship with the United States: We buy a lot of their stuff, and they buy a lot of our debt. A few members even seem to understand the connection between the two: Put simply, China takes the money it makes selling us cheaply manufactured goods and lends it back to us at a low rate of interest. But most members of the House either don't understand that connection or don't care, because they passed a bill last week aimed at raising the price of the products we buy from China, on the theory that doing so would bring manufacturing jobs back to the United States. Would it?

In a word, no. Advocates of this policy have, wittingly or not, bought into a myth about why we import so much stuff from China. According to the myth, China is outcompeting us on the manufacturing front because it keeps its currency, the renminbi, artificially undervalued, thus making its exports cheaper in dollar terms than they should be. But how do these advocates know what the renminbi *should* be worth? Well, they know it should be worth more than it is: China's decision to recycle the dollars we spend on their exports — using those dollars to buy U.S. Treasury bonds — keeps the value of the renminbi low and stable relative to the dollar. If the Chinese followed the more conventional approach of converting those dollars into their own currency, then its value would appreciate because of the increase in demand for renminbi. This would — theoretically — make the stuff we import from China more expensive in dollar terms and the stuff we sell to them relatively cheaper.

This would — again, theoretically — create jobs in the United States, because the Chinese would buy more of our exports and, less plausibly, corporations would source more of their low-value-added manufacturing in the United States. The theory breaks down, however, when one considers that what we buy from China and what we sell to China are very different things. Consider the facts: Over the last decade, as U.S. manufacturing employment fell, U.S. manufacturing output went up, indicating a shift from low-value-added to high-value-added manufacturing. Unemployment remained low as workers migrated to the service sector, while low-value-added manufacturing moved overseas — not just to China, but to other developing countries where lower costs vis-à-vis U.S. manufacturers offered a comparative advantage. If China's currency policy has given it any trade advantage at all, it has mostly been an advantage over other low-wage countries that export to the United States.

A crackdown on China would be a full-employment plan for other developing countries: Unless we hit them all with tariffs, it would probably not create a single low-skilled job here. It might destroy a few, however, as retailers would be forced to make costly adjustments and establish new lines of trade with Vietnam and Bangladesh. How about exports? Here the case is a bit more plausible, but only a bit: Demand for the kind of high-value-added manufactured products that the Chinese buy from us — airplanes from Boeing, construction equipment from Caterpillar — will not be much affected. The manufacturers of those products are much more worried about the possibility of a trade war with China than they are about the value of the renminbi: Just ask them.

Meanwhile, the effects of actually enacting sweeping tariffs on Chinese imports are unknowable: If China decided to defy the sanctions and refused to let its exchange rate float, then we suspect the Chinese government would impose retaliatory countermeasures, leading to widespread layoffs at the aforementioned U.S. exporting concerns. If, on the other hand, China succumbed to the pressure to let its currency appreciate, then its own export-oriented businesses would be forced to cut back as they lost business to manufacturers in other low-wage countries. It's hard to imagine that the consequences for China — social upheaval, economic ruin, and rampant speculation as financiers took advantage of the suddenly floating exchange rate — would be good for a United States interested in international economic accord and global stability. The consequences could be more pedestrian, though contrary to the intentions of Congress: The Cato Institute's Dan Ikenson has pointed out that the Chinese let the renminbi appreciate by over 20 percent between 2005 and 2008, and the U.S. trade deficit with China continued to increase.

All this is to say nothing of what might happen to the other side of the equation: What happens to long-term interest rates if China stops lending us our own money back? This question raises another one: At a time when the Federal Reserve has more than doubled its balance sheet — when the dollar is taking a beating and the gold price is spiking as the central bank contemplates further monetary easing — what right does the United States have to call anyone else a currency manipulator? Having discovered that we cannot borrow and spend and print our way out of our own past policy mistakes (and lacking the political will to give the private sector room to breathe by cutting spending *and* taxes), the U.S. government is desperate for something else to boost the economy, and a growing number of policymakers appear to have decided that we must export our way out of the crisis. Thus our ultimatum to the Chinese: Save us at your own expense, or else! That is a disgraceful admission of weakness, and a fitting coda for one of the worst Congresses in recent memory.