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GRISWOLD: Schumer undervalues trade with China

By Daniel Griswold

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ANALYSIS/OPINION:

The drums of a trade war with China continue to beat in Congress even after the Chinese government announced earlier this month that it will allow the yuan to resume appreciating against the U.S. dollar.

Led by Sen. Charles E. Schumer, New York Democrat, congressional critics of Chinas currency policy assert that tl yuan is intentionally undervalued by as much as 40 percent. They argue that the undervalued currency makes Chine goods artificially cheap in the U.S. market, hurting U.S. manufacturers, while it stifles U.S. exports to China, fuelin our big bilateral trade deficit.

Theres an element of truth to all of that. Chinas central bank does tightly manage the value of its currency in the foreign-exchange market, as do most other less-developed nations. An undervalued currency does make a nations exports more competitive while making imports more expensive. But the claims made by the critics are wildly overvalued in the debate and do not justify any resort to higher tariffs against Chinese goods.

Exchange rates have only limited effects on bilateral trade balances and can be swamped by more fundamental factors. We run a large bilateral deficit with China not because of an undervalued yuan, but because China specializ in making consumer goods — such as shoes, clothing, toys and household appliances — that American consumers love to buy. Because of our low national savings rate, we in turn offer attractive assets, such as Treasury bills, that the Chinese are equally eager to buy from us.

For a number of reasons unrelated to exchange rates, the growth of our trade deficit with China has actually slowed in the past year. According to the latest monthly report from the U.S. Department of Commerce, our trade deficit with China grew only 6 percent in the first four months of 2010 compared with the same period last year, from $67 billion to $71 billion. That compares with a 46 percent jump in our trade deficit with all other countries, from $78 billion to $114 billion.

Chinas "manipulated" currency has not blunted U.S. exports to China, nor unleashed a flood of imports. In the first four months of 2010, U.S. exports of goods and services to China were up 41 percent, twice the rate of growth of exports to the rest of the world excluding China. Meanwhile, imports from China were up 14 percent year to date, compared with a 25 percent increase in imports from the rest of the world.

If U.S. exports to and imports from the rest of the world had grown at the same rates as they did with China during the first part of 2010, our overall trade deficit would have been $110 billion smaller than it actually was. If Mr. Schumer believes the trade gap is such a threat, perhaps he should aim his legislation at countries where our deficit has been growing so much faster than it has with China.

Of course, there is no evidence that the trade deficit is a major or even a minor cause of whatever the senator believ is ailing U.S. manufacturing. Manufacturing output fell sharply during the recent recession, but so too did manufacturing imports and the trade deficit. Now that the trade deficit is growing again, so too is manufacturing output.

According to the Federal Reserve Board, real manufacturing output at U.S. factories is up more than 8 percent from year ago. The Institute for Supply Managements monthly index shows that the U.S. manufacturing sector has been expanding for 10 straight months. Do we really want to pick a unilateral trade fight with one of our biggest custome in the world just as American manufacturers are finding their feet again?

Chinas economic managers understand that a more flexible currency will allow them to pursue a more independent monetary policy aimed at controlling inflation and avoiding asset bubbles. A stronger currency also will allow Chin producers to buy imported oil and other inputs more cheaply, lowering their production costs and partly offsetting tl impact of a higher yuan on export prices.

The Obama administration deserves credit for choosing to engage Chinas leaders on the currency issue rather than threatening unilateral action that would only make it harder for the Chinese government to do the right thing.

• *Daniel Griswold is director of the Center for Trade Policy Studies at the Cato Institute in Washington and the author of the 2009 Cato book "Mad About Trade: Why Main Street America Should Embrace Globalization."*