U.S. currency push on China no slam dunk

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By Paul Eckert - Analysis

WASHINGTON (Reuters) - China's currency is clearly undervalued, but pressure on Beijing to make its currency rise in value won't trim the U.S. trade deficit with China or reduce the jobless rate, say American economists.

Political pressure is building on the Obama administration to name China a "currency manipulator" in a mid-April report, and lawmakers are threatening to slap tariffs on Chinese goods to offset any export subsidy a cheap currency gives China.

However, many trade economists and businessmen say that at best, a heavy-handed U.S. approach on currency will fail. At worst, it could backfire, sparking a U.S.-China trade war.

Instead, Washington should address the currency and other factors behind global financial imbalances in a multilateral setting. Bilaterally, the Americans should focus on Chinese trade barriers that suppress sales to China and may violate World Trade Organization (WTO) commitments, they say.

"The currency is undervalued, period. It's also a structural distortion because the world's second-largest economy shouldn't be pegging to the largest economy," said Derek Scissors of the Heritage Foundation in Washington.

Economists say China's currency is pegged to the dollar at a rate that is between 15 and 40 percent lower than the level markets would set if the yuan were freely traded.

Slamming the Chinese over currency is politically appealing

in an election year in which U.S. unemployment is near 10 percent and China's trade surplus is expanding again.

JOBS AND TRADE

Economically, however, "this is a dead end," warned Scissors. "If you're looking to create jobs, the currency change won't do it."

"The Chinese have reserved large parts of their market for the state -- by rules, by subsidies, by everything you can imagine -- and that's the big cap on U.S. exports, not the currency," he said.

The U.S. Trade Representative's office on Wednesday issued an annual report that cited a range of Chinese regulations, subsidies and policies that favor state firms over foreign firms and contravene China's WTO obligations.

Earlier this month, the left-leaning Economic Policy Institute issued a study that said China's "currency manipulation" and other trade policies caused the loss of as many as 2.4 million U.S. jobs between 2001 and 2008.

With the U.S. economy having shed 8.4 million jobs since December 2007, many U.S. lawmakers have embraced the currency-unemployment nexus suggested in the EPI report.

The U.S.-China Business Council, whose members do business in China, retorted that the EPI analysis was "several decades wrong" because China is merely the newest supplier of goods that its Asian neighbors used to sell to the U.S. market.

Americans who blame job loss on China trade ignore all the jobs supported by imports and operate "on the faulty assumption that every product imported from China would have been made in the U.S. otherwise," said John Frisbie, USCBC president.

Daniel Ikenson, an economist at the CATO Institute, said that when China eased the yuan-dollar peg between 2005 and 2008, the Chinese currency appreciated 21 percent -- but U.S. imports from Chinese increased by 38.7 percent.

"The currency issue is a problem because there's a false association with the trade deficit and the trade deficit is falsely associated with job loss," he said.

MULTILATERALIZE IT?

The EPI's Senior International Economist Robert Scott, author of the job report, shrugs off critics who say his call for a sharp appreciation of the Chinese currency is futile.

"If you make Chinese goods 40 percent more expensive and make U.S. goods 40 percent less expensive, that's got to have an impact on ultimate sales of goods in both countries and ultimately, on jobs," he said.

But Scissors counters that a Chinese currency appreciation would simply make "jobs move to other countries that are low-cost producers who couldn't quite catch up to the Chinese but now they can: Vietnam, Indonesia, Mexico, India."

Speculation about how the U.S. Treasury Department will handle the semi-annual currency report due on April 15 has swung from predictions of a strong likelihood that China will be cited to talk that Treasury might postpone the decision.

The Bush administration often put off the finding to avoid friction with Beijing ahead of key events, and neither the Obama administration nor its predecessor has ever declared China a manipulator.

The Obama administration is hosting a nuclear disarmament summit on April 12-13 that it hopes Chinese President Hu Jintao will attend. U.S. cabinet officials will travel to Beijing for an annual strategic and economic dialogue meeting in late May.

A currency manipulator ruling simply requires Washington enter into consultations with China and the International Monetary Fund. Some analysts say that would be a good thing because it would "multilateralize" a testy bilateral dispute and stave off broad protectionist moves by the U.S. Congress.

(Editing by Cynthia Osterman)