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China Trade and American Jobs

Studies suggest that one-half to two-thirds of the value of 'Chinese' imports is added in other countries, including the U.S.

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President Obama's goal of creating American jobs has thrust the Chinese currency onto center stage in Washington, where an undervalued renminbi is blamed for the trade deficit with China, and the deficit is blamed for U.S. job losses.

Growing acceptance of that sequence of fallacies threatens our economy, as Congress considers restrictions on imports from China to compel the Chinese government to appreciate its currency. In true Washington fashion, these policies will reduce Americans' real incomes and destroy U.S. jobs in the name of economic growth and job creation.

Although the Chinese currency appears to be undervalued, the evidence suggests that appreciation will not reduce the bilateral trade deficit. Between July 2005 and July 2008 the renminbi rose 21% against the dollar, to $.1464 from $.1208, where it had been pegged since 1997. But the trade deficit, according to the trade statistics compiled by the U.S. Census Bureau, nevertheless increased to $268 billion from $202 billion over that period.

Textbooks say that the Chinese should increase purchases of American products when the renminbi's value increases against the dollar—and indeed they did by $28.4 billion. But exports to China were already increasing rapidly before the currency began to appreciate, rising by $19 billion between 2002 and 2005, according to the Census Bureau.

Textbooks also predict that Americans will reduce their purchases of Chinese products in response to an appreciating renminbi. But U.S. imports from China between 2005 and 2008 actually increased by a whopping $94.3 billion, or 39%.

Import value is measured officially as price times quantity. If price rises by a larger percentage than the quantity demanded decreases, then import value is going to rise—adding to the deficit. And Americans did not reduce their consumption of Chinese goods at all in response to the stronger renminbi. That suggests a high degree of price-inelasticity. Consumers will endure higher prices with respect to products for which there are perceived to be few substitutes.

This means that forcing China to appreciate its currency through sanctions will impose higher prices on American consumers, thereby reducing Americans' real incomes. Higher prices at Wal-Mart and Target—two of the biggest retailers that bring Chinese goods to U.S. customers—will be felt especially hard by lower-income Americans. Trade sanctions would in effect amount to a regressive tax.

There is another explanation for Americans' continued purchases of Chinese goods despite their weaker dollars. A stronger renminbi increases the purchasing power of Chinese producers, who rely heavily on imported raw materials, capital

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equipment and components for their production. Because the inputs are now cheaper, Chinese producers can lower their export prices to preserve market share abroad.

The relationship between currency and the trade deficit is weaker than policy makers presume. Weaker still is the relationship between the trade deficit and U.S. job loss.

Sen. Charles Schumer (D., N.Y.) and others on Capitol Hill attribute 2.4 million American job losses between 2001 and 2008 to the bilateral trade deficit. This figure comes from the union-backed Economic Policy Institute. EPI's methodology is not taken seriously by most economists because it approximates job gains from export value and job losses from import value, as though there were a straight line correlation between the figures. And it pretends that imports do not create or support U.S. jobs.

But U.S. producers—purchasing raw materials, components and capital equipment—account for more than half of the value of U.S. imports annually, according to the U.S. Bureau of Economic Analysis. Those imports support U.S. jobs in a wide range of industries.

Furthermore, according to the results from a growing field of research, only a fraction of the value of U.S. imports from China represents the cost of Chinese labor, materials and overhead. Most of the value of those imports comes from components and raw materials produced in other countries, including the U.S.

In a 2006 paper, Stanford University economist Lawrence Lau found that Chinese value-added a ccounted for about 37% of the total value of U.S. imports from China. In 2008, using a different methodology, U.S. International Trade Commission economist Robert Koopman, along with economists Zhi Wang and Shang-jin Wei, found the figure to be closer to 50%. In other words, despite all the hand-wringing about the value of imports from China, one-half to nearly two thirds of that value is not even Chinese. Instead, it reflects the efforts of workers and capital in other countries, including the U.S. In overstating Chinese value by 100% to 200%, the official U.S. import statistics are a poor proxy for job loss.

Seldom noted in the union-controlled discussion of trade on Capitol Hill is that the jobs of large numbers of American workers depend on imports from China. The proliferation of transnational production and supply chains has joined higher-value-added U.S. manufacturing, design, and R&D activities with lower-value manufacturing and assembly operations in China.

According to a widely cited 2007 study by Greg Linden, Kenneth L. Kraemer and Jason Dedrick of the University of California, Irvine, each Apple iPod costs $150 to produce. But only about $4 of that cost is Chinese value-added. Most of the value comes from components made in other countries, including the U.S. Yet when those iPods are imported from China, where they are snapped together, the full $150 is counted as an import from China, adding to the trade deficit and inflating EPI's job-loss figures.

In reality, those imported iPods support thousands of U.S. jobs up the value chain—in engineering, design, finance, manufacturing, marketing, distribution, retail and elsewhere. A 25% tariff on imports from China would penalize the non-Chinese companies and workers who create most of the iPod's value.

Consider how many fewer iPods Apple would sell; how many fewer jobs iPod production, distribution and sales would support; how much lower Apple's profits and research and development expenditures would be; how much smaller the markets for music and video downloads, car accessories, jogging accessories, and docking stations would be; and how many fewer jobs those industries would support. Multiply that by the hundreds of other devices and gadgets, computers and Blu-Rays, and other products designed in the U.S. and assembled in China from components made in the U.S. and elsewhere.

Those are the economic costs that Congress and the president would inflict by imposing trade

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sanctions on imports from China.

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