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Deadlines and Delays: Chinese Revaluation Will Still Not Bring American Jobs

Derek Scissors, Ph.D.

The Department of the Treasury has delayed its decision on whether to label China a currency manipulator. Prominent Members of Congress attacked this delay, insisting they will seek trade action against the PRC. At the heart of congressional demands is the idea that a Chinese revaluation would mean millions of additional American jobs. This idea is almost surely wrong.

The *almost* is there only because advocates of revaluation are often vague about how large a change is supposed to manage this feat. Such vagueness should come as little surprise—when one examines American jobs and the value of the RMB, the thread between the two is very, very thin. No currency revaluation of any feasible size will create more than a few thousand American jobs.

The reason for the minimal impact is simple: The exchange rate with China is not genuinely important to the U.S. economy. There are other policies China has adopted, or not adopted, that are more important. There are policies the U.S. has adopted, or not adopted, that are more important. The U.S. should focus on these more important policies, such as Chinese subsidies and the U.S. budget deficit, not an exchange rate shift that will achieve almost nothing.

False Logic. The logic of the exchange rate argument is faulty. The PRC's undervalued exchange rate is supposed to cause the U.S. to run a large bilateral trade deficit, which is supposed to cost many American jobs. The second part of that claim—a bilateral trade deficit costs jobs—is hard to disprove but actually makes very little sense. The first part—an undervalued exchange rate causes the U.S. to run a large bilateral trade deficit—is demonstrably wrong.

From January 1994 to December 1997, the RMB appreciated 5 percent against the dollar. The annual trade deficit still rose from $23 billion before the appreciation to $57 billion afterward. From January 1998 through June 2005, the RMB essentially did not move at all against the dollar. The trade deficit rose to $162 billion for 2004. From July 2005 through July 2008, the RMB rose 20 percent against the dollar. The trade deficit nonetheless rose to $268 billion for 2008. From July 2008 to the present, the RMB did not move against the dollar. This time the trade deficit fell to $227 billion for 2009.[1]

Over the past 15 years, when the RMB has been stable against the dollar, the trade deficit has both fallen and risen. But when the RMB rises against the dollar, the trade deficit rises. This is the evidence of what actually does happen, not merely what some assume is going to happen.

How can this be? The explanation goes back to the fact that the exchange rate is not important in the U.S.–China economic relationship. The bilateral

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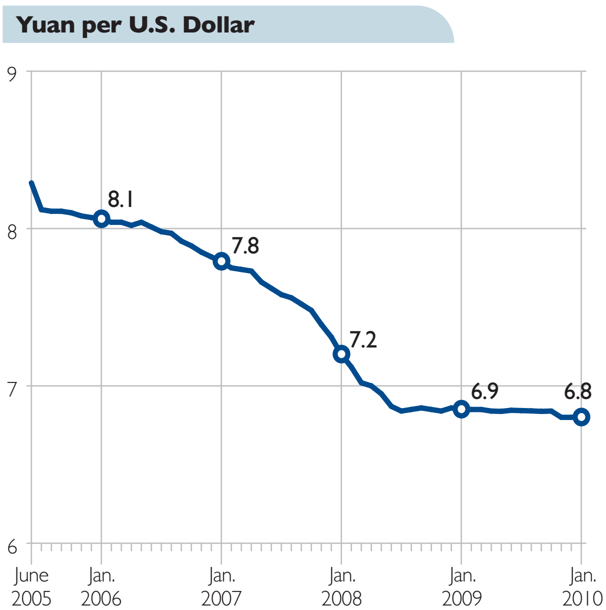
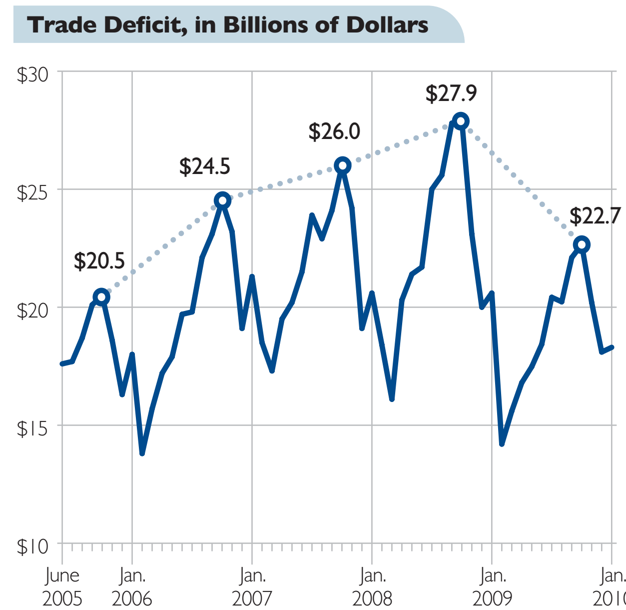
The Yuan and the U.S.–China Trade Deficit





Sources: OANDA, FXHistory: Historical Currency Exchange Rates, at *http://www.oanda.com/convert/fxhistory* (April 1, 2010), and U.S. Census Bureau, Foreign Trade Division, Data Dissemination Branch, "Trade with China: 1995," at *http://www.census.gov/foreign-trade/balance/c5700.html#1995* (April 1, 2010).

Chart 1 • WM 2855 heritage.org

trade deficit chiefly expands when American demand is strong and contracts when, as now, demand is weak. That is sensible because the U.S. has by far the larger, richer economy, so trends in American demand are typically more important than what happens in the PRC.

Chinese Mercantilism. Moreover, within the set of only Chinese policies, the RMB still does not matter much. China has a huge arsenal of market intervention tools at its disposal. Exports are encouraged in various ways—for example, through tax adjustments. These would certainly be used to offset a currency change, as they have been in the past.[2]

More fundamental are the many and powerful ways that the PRC subsidizes its state enterprises. Land has become very expensive in many of the coastal cities through which China trades, but all land is ultimately owned by the state. State firms can be granted land as it suits central or local government, cutting their costs in sometimes dramatic fashion. Capital subsidies are even more potent tools. In response to the financial crisis, state banks lent unprecedented sums to state firms without regard for repayment.[3]

The most pernicious intervention is regulatory protection. Many large state firms are geographic

1. U.S. Census Bureau, "Trade in Goods (Imports, Exports and Trade Balance) with China," March 11, 2010, at *http://www.census.gov/foreign-trade/balance/c5700.html#2009* (April 5, 2010); Oanda, "Historical Exchange Rates," at *http://www.oanda.com/currency/historical-rates* (April 5, 2010).
2. State Administration of Taxation, "70% Machinery and Electronic Products Were Granted Full Export Tax Rebate," at *http://www.chinatax.gov.cn/n6669073/n6669118/9195918.html* (April 1, 2010).
3. Business Week, "Will China's Bank Bailout Do the Trick?," January 26, 2004, at *http://www.businessweek.com/magazine/content/04_04/b3867133_mz035.htm* (April 5, 2010); Gady Epstein, "China: Boom Or Bust?," *Forbes*, February 02, 2010, at *http://www.forbes.com/2010/02/11/china-bubble-mao-ha-renminbi-beijing-dispatch.html* (April 5, 2010).

monopolies—sole providers of goods or services in a large area. When competition is allowed, it is tightly limited. Sectors that are mandated to be utterly dominated by the state include aviation, coal, gas, oil, petrochemicals, power, shipping, and telecom. State firms must also lead in autos, construction, information technology, machinery, and metals.[4] Not legally reserved but nonetheless entirely dominated by the state are grain distribution, insurance, railways, and, crucially, banking.

Guaranteed revenue and economies of scale make state firms modestly competitive as exporters when they would otherwise be uncompetitive. The real harm, however, is to imports of goods and services from the U.S. The decree of state predominance caps the total share available to all domestic private and foreign companies, leaving American producers in a vicious battle for permanently minor market segments. This is a far more stringent limitation than an undervalued currency.

Not the RMB but the Trade Deficit? Protectionists might ultimately accept these facts and agree that an RMB revaluation will accomplish nothing. However, they could still hold on to the idea that the trade deficit with China costs American jobs. The idea of the bilateral deficit costing some jobs cannot be rejected outright on the basis of the record, but it does not stand up well to scrutiny.

First, there are those inconvenient numbers. The bilateral deficit rises not when the yuan is falling but when U.S. demand is strong. And strong American demand should mean more American jobs, not fewer. Second, the claim that imports cost jobs is narrowly based. Imports also create jobs in transport, retail, and other areas. In addition, the mirror image of a trade deficit is a capital surplus. And incoming capital creates jobs. Even the aggregate U.S. trade deficit over all countries may not cost jobs when gains from imports and capital inflow are counted.[5]

Third, China is just part of the story—action against China will directly involve other countries. Chinese subsidies do not take jobs from the U.S.; they take jobs from others competing for the American market. If Congress imposes tariffs on Chinese clothing, toys, furniture, and basic household appliances, jobs will not move to the U.S. They will go to India, Vietnam, Mexico, Indonesia, Bangladesh, and other low-cost producers.

East Asia, Percentage of Total U.S. Trade Deficit

	1987	2007
Original ASEAN*	4.7%	5.0%
Hong Kong	3.9%	–1.6%**
Japan	37.0%	10.4%
Korea	5.9%	1.6%
Taiwan	13.1%	1.5%
China	1.8%	32.0%
Total	**66.4%**	**48.9%**

* Indonesia, Malaysia, Philippines, Singapore, and Thailand.
** Denotes an American surplus.

Source: U.S. Census Bureau, Foreign Trade Statistics, U.S. Trade in Goods (Imports, Exports and Balance) by Country, at *http://www.census.gov/foreign-trade/balance* (April 1, 2010).

Table 1 • WM 2855 heritage.org

There is precedent for such a migration. The U.S. trade deficit set a record in 1987 and lasted until the mid-1990s. At that time East Asia accounted for two-thirds of the deficit, led by Japan, while China was a minor player. Prior to the global crisis, the trade deficit peaked again and at a much higher level than in 1987. Moreover, China's role in this larger deficit grew tremendously. However, the roles of Japan, Taiwan, Korea, Hong Kong, and Singapore in the deficit all declined sharply. East Asia as a whole now contributes less than half the deficit.

One key change was soaring energy imports; another was that East Asian production for export moved to China in response to early Chinese reform,

4. Zhao Huanxin, "China Names Key Industries for Absolute State Control," *China Daily*, December 19, 2006, at *http://www.chinadaily.com.cn/china/2006-12/19/content_762056.htm* (April 1, 2010).

5. Ambassador Terry Miller, "China Job Loss Claims Miss the Big Picture," Heritage Foundation *WebMemo* No. 2845, March 24, 2010, at *http://www.heritage.org/Research/Reports/2010/03/China-Job-Loss-Claims-Miss-the-Big-Picture*.

the Asian financial crisis, and a stagnant Japan. The U.S. can force that production out of China, but it will simply relocate again elsewhere in Asia and around the world. U.S. job gains will be trivial.

Recommendations. There are steps that may truly bolster American employment for the long term.

The main step is erasing the budget deficit. Government debt is now the biggest threat to sustained U.S. prosperity and leadership, by far. This is not a matter of ideological or partisan debate. In comparative importance, the value of the RMB is a footnote. Also, getting America's own house in order would improve the U.S. position economically and diplomatically prior to making difficult demands on the PRC, especially since the budget deficit is chief among Beijing's expressed concerns.

Regarding the difficult demands of China, the Obama Administration has multiple options, all of them challenging. The direct analog to the American budget deficit is Chinese bank lending, both on-book and off-book.[6] A pledge of verifiable, comprehensive rollbacks of harmful policies by both is an obvious route.

A superior alternative, because it involves market-oriented reform, is for the U.S. to establish a schedule of budget deficit reductions and for the PRC to establish a schedule for the opening of its capital account. This is a stated Chinese goal that was lost in the general abandonment of the market. It would have the effect of slicing into lending, because money could leave the country in response to non-commercial behavior by Chinese financials. It would thus make state firms less unnaturally competitive at home and overseas.

The most valuable, but also most contentious, demand would be explicit limits on the extent of state dominance in most industries. This would not be a call for an end to state control but for transparency concerning the extent of such control followed by partial retrenchment in what Beijing deems the less important sectors. These actions would open the door further for American goods and services, creating a more open bilateral trade relationship.

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6. Andrew Peaple, "Tidying Up After China's Lending Binge," *The Wall Street Journal*, December 21, 2009, at *http://online.wsj.com/article/SB10001424052748704238104574603272836308480.html* (April 5, 2010).