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## ECONOMIC NEWS UPDATE

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7 October 2005

It takes a lot to get Alan Greenspan on an airplane these days. He has enough to do at home: tend to the economy, develop monetary policy that can cope with the profligate fiscal policy concocted by the President and the Congress; and begin packing his office so that he can be out the door when his term expires at the end of January. But this week he is off to Beijing.

The Treasury was scheduled to deliver a report to Congress this month in which it would have to decide whether to name China as a currency manipulator. Since it is clear to everyone that China is artificially depressing the value of its yuan, this presents Treasury Secretary John Snow with a problem. If he brands China a currency manipulator, congressmen who have been calling for a 27.5% tariff on all imports from China -- their estimate of the extent of the undervaluation of the yuan -- will pounce. Chuck Schumer, the New York senator who could not be convinced that John Roberts is qualified to serve as Chief Justice,

would like nothing better to add to his credentials as a Bush-tormentor by leading the charge for protection from Chinese imports.

With the trade deficit set to rise to more than 6% of GDP -- for some reason considered by experts to be unsustainable -- support for a restriction on imports from China would then gather force. Indeed, the President already has been forced to bow to protectionist pressure by limiting the importation of some apparel products made in China.

That's why Greenspan, who fears that rampant protectionism can bring on a worldwide recession, is hopping on a Beijing-bound plane with Secretary Snow. The White House is hoping he can help it find a way to avoid hanging the label "manipulator" on China when the Treasury files its delayed report with congress next month. China's decision to allow a limited float of its currency, which has recently appreciated a tiny bit, will give Greenspan and Snow something they can say, but it is unlikely to be enough to appease the trade hawks

in congress. My own guess is that Bush is gambling that the Fed Chairman's prestige, put at the service of a statement that things are moving in the right direction, and that the deficit has multiple causes in addition to the undervaluation of the yuan, will head off draconian protectionist measures, something reassurances by Snow alone could not accomplish.

This strategy carries something of a risk for the administration. Greenspan is known to be upset by the fiscal deficit, which he feels is contributing to the global imbalances that must sooner or later result in a decline in the dollar, rising interest rates, higher inflation, and pressure on the Fed to tighten even if the economy softens. So he might well accompany reassurances to congress about the direction of Chinese trade policy with a blast at the White House and the congress for failing to get America's fiscal house in order. Already under pressure because of his delayed reaction to Katrina, a variety of potential scandals, and now from his conservative supporters because of his refusal to appoint a distinguished, conservative constitutional lawyer to join the estimable John Roberts on the Supreme Court, the last thing the President needs is a public dressing down by Greenspan.

Although China is the congress's favorite whipping boy, the increase in the US trade deficit is not due to the flood of Chinese imports alone. The high price of crude oil will accelerate the flow of dollars to Middle Eastern and other producers, as will imports of gasoline from Europe and elsewhere. The

apparent decision by consumers to shun the big, gasoline-guzzling sports-utility vehicles that are the mainstay of the profits of American car makers will probably increase imports of Japanese and other imported vehicles that consume less gasoline per mile. And the slow growth of Europe's economies shrivels the market for American exports.

Nor is the rising trade deficit due solely to China's interventions in currency markets. The fact is that Chinese labor costs are so far below those in the United States that even a major upward revaluation of the yuan would be unlikely to stem the flow of textile and other products with a high labor component.

And revaluation would not help key American exporters unless accompanied by the Chinese regime's willingness to crack down on piracy that is depressing our exports of intellectual property. China's persistent refusal to stop the piracy of software, films and other intellectual property has important lobby groups, the White House, and congress up in arms. "Intellectual property rights violations are a crime and we don't believe we should be negotiating crimes with our trading partners," Carlos Gutierrez, Commerce Secretary, told the American Chamber of Commerce in a speech in Beijing a few months ago.

Besides, those politicians who want to cut imports from China had better be careful what they wish for. China uses the flood of dollars that it receives for its goods to buy US Treasury bills, thereby keeping interest rates lower than they would

otherwise be. These low interest rates are fueling the housing boom, and the increase in house values allows consumers to cash out some of the equity so that they can continue of the buying binge that has kept the economy growing at 3.5%-4.0%. Should a reduced flow of dollars cause the Chinese authorities to cut back their purchases of American IOUs, especially at a time when some sectors of the economy are showing a bit of weakness, congress might find that it has indeed reduced Americans' appetite for imported goods -- by causing a recession.

America is lucky that it still has Greenspan to call upon. He just might be able to come up with a solution that propels China in the right direction, at a pace sufficient to stifle congress's protectionists, but slow enough to avoid facing his successor with a currency crisis as he moves into the Chairman's seat.

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**THE SUNDAY TIMES**

A version of this Update appeared in  
The Sunday Times (London)