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ECONOMIC NEWS UPDATE

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Sino-American Relations Under Strain

The new American Treasury Secretary uses a senate hearing room to accuse the Chinese of manipulating their currency, and the Chinese Premier uses the Davos gathering of the moguls to accuse America of wrecking the world financial system. Not an auspicious beginning for Sino-American relations in the new era of the great believer in softly, softly diplomacy, Barack Obama.

Tim Geithner has by now settled into his new job at the Treasury. It no longer matters that Geithner was the Fed's man on Wall Street while the excesses and chicanery reached their peak. Or that the new Secretary of Treasury decided to avoid paying his income taxes, despite repeated notices of his liability from his then-employer, the International Monetary Fund. Or that it was Geithner, along with his predecessor, Hank Paulson, who decided to let Lehman Brothers go

under, bringing the financial system to the verge of collapse. That's all behind him.

What might be ahead is a trade war. At least, that's what many observers believe Geithner had in mind when he told the Senate during his confirmation hearings, that he believes that China is "manipulating" its currency to maintain it at a low value so as to stimulate its exports. "Manipulate" is the word that upsets the Chinese, and imports are the things that most upset the trade unions and congressional Democrats who see them as destroying jobs in America -- never mind the benefits to consumers as they prowl the aisles of Wal-Mart.

There are three reasons to believe that this was not just another blunder by Geithner. The first is that the administration rushed out a statement that Geithner was saying no more than President Obama had said on the campaign trail.

The second is that Geithner was reading from a prepared statement, not merely making some remarks in response to a question. "President Obama, backed by the conclusions of a broad range of economists, believes that China is manipulating its currency," wrote the then-nominee. Premeditation matters, and the use of the inflammatory "manipulation" clearly was a carefully considered act.

The third is that Geithner is well aware of Chinese sensibilities. He and his family have a long association with, and knowledge of, the politics of Asia and China. It would have been unusual in past years for any important Chinese official to visit the U.S. and not have a private tête-à-tête with Geithner, who has studied Chinese and Japanese, and lived in India, Thailand and Japan, as well as in China. His father is director of the Asia program at the Ford Foundation. Not quite old China hands, by the standards of the British elite, or our movies, but close enough to know just what will set the Chinese leaders' teeth on edge.

Which Geithner most certainly did. China's communist leaders, lacking democratic legitimacy, know that unless they can keep job losses down as their economy cools, they will face even more social unrest than has been bubbling to the surface in recent years. They know, too, that the recession in the U.S. and Europe is cutting into their exports, causing factory closings and lay-offs. The last thing they want is to see the yuan appreciate further against the dollar, reducing the competitive advantage that made-in-

China goods have in U.S. markets. Along comes Geithner to bring smiles to the face of Chuck Schumer, the China-bashing New York senator who has been calling for high tariffs on Chinese goods to offset the advantage the Chinese gain from manipulating the yuan, rather than letting it float. "This is a big step," Schumer announced with unconcealed glee.

Geithner's charge is not without substance. China has indeed kept its currency undervalued to stimulate its exports, and although Hank Paulson's trips to Beijing in pursuit of a strategic dialogue did produce a bit of an up-tick in the yuan, that stopped abruptly when the Chinese economy ran into strong headwinds.

With the U.S. economy in recession, and the taxpayers about to spend perhaps \$1 trillion to get it moving, the notion that tax cuts and new spending will end up buying goods made-in-China-by-Chinese-workers is increasingly unpalatable. That's why politicians are insisting that the stimulus package include "buy American" provisions.

In the past, free traders could cite history, arguing that the Great Depression was prolonged by the protectionist wave that rolled across the world. Or the great Adam Smith, who demonstrated the benefits of free trade. But voters are neither historians nor economists: few have plowed through the massive literature on the Great Depression or Smith's "Wealth of Nations". Besides, the long-run inefficiencies created by protectionism pale by comparison with the jobs lost here and now, especially in the minds of

trade union leaders and the Democrats they have helped to elect.

One Robert Cassidy also has his doubts about the benefits of our trade relations with China. Cassidy, President Clinton's assistant U.S. trade representative for the Asia-Pacific region is the man who put together the deal that persuaded congress to normalize trade relations with China and permit China to join the World Trade Organization (WTO). Now, regrets he has more than a few. Earlier this week he told an audience at the liberal Economic Policy Institute that China's manipulation of the yuan is making American goods uncompetitive in China, and inducing U.S. companies to close factories here and move production to China. Not exactly what he had in mind when he concluded the trade deal with China. For the past decade China has shipped us goods, and we have shipped China bits of paper with pictures of American Presidents. China has shipped those dollars back to us to buy the IOUs our deficit-ridden government is selling. Now, the Treasury is about to step up its borrowing to fund the stimulus, the auto industry, the banks, digital converters, a partial government takeover of the health care industry, and myriad items on the wish lists of long-frustrated congressional liberals. If China decides it doesn't want to buy the new IOUs, interest rates here will climb, offsetting the effects of much of Obama's stimulus package. Secretary Geithner might then find that he can't peddle the billions in IOUs he will soon be issuing, and regret emboldening the

Schumers of the world to believe that the Obama administration intends to replace talk, talk, with war, war -- trade war, that is.

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