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## Trade and the economy

### America's fear of China

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#### China is a far-from-cuddly beast; but bashing it is a bad idea

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IF THE guest list determined a meeting's value, the Strategic Economic Dialogue between China and America on May 22nd would be a roaring success. Almost half the Chinese cabinet is trooping to Washington, DC, for the second of the twice-yearly discussions, conceived by Hank Paulson, America's treasury secretary, between the world's largest economy and its fastest-growing one. The process was designed, in large part, as an antidote to the latest case of Asiaphobia among America's politicians. It is not working.

The itch to get tough with Beijing is urgent in Congress. Brandishing China's growing bilateral trade surplus as proof, congressmen from both parties have denounced the country as a currency manipulator, an illegal export-subsidiser, a violator of rights to intellectual property and all-round trade scoff-law. China-bashers have introduced a dozen bills in the new Congress. Some are bound to languish, but others may be passed—though there would then be further hurdles to jump, not least the president's power of veto (George Bush has other conflicts on his mind). The most threatening include proposals that would declare China's cheap currency an illegal subsidy and allow American firms to seek compensatory tariffs.

Politics in Beijing is less open, but the circumstances are similarly unhelpful. Because they have no electoral legitimacy, China's Communist leaders need to deliver the economic goods even more than most congressmen do. Worried about unemployment, the Chinese are loth to let their currency, the yuan,

appreciate much faster than at today's snail's pace. And as with all dictatorships, there is the need to seem tough. With the five-yearly Communist Party congress only months away, China's president, Hu Jintao, cannot be seen to be bowing to American pressure on the yuan or anything else.

## Japanese lessons

Thankfully, an all-out trade war remains unlikely. Congressional leaders seem inclined to act within the rules of the World Trade Organisation (WTO), which limit the scope and scale of any barriers that America can unilaterally impose. And some friction is to be expected in a trading relationship worth well over \$300 billion a year. But although today's tensions are not cause for panic, they are a costly and unnecessary distraction—and potentially worse than that.

One worrying parallel is the Japanophobia of the 1980s and early 1990s. Back then, Japan's rising bilateral trade surplus and its mounting foreign-exchange reserves were seen as “proof” of its manipulated currency and mercantilist attitude. America's paranoia deepened as its jobless rate climbed—especially when the Japanese started buying landmarks like the Rockefeller Centre. In fact, Japan's bubble economy ended up bursting; but not before an outbreak of foolish protectionism. The economic tension even undermined support in both countries for America's security alliance with Japan.

The case against China is even weaker than the one against Japan was. Its economy is far more open. Though much poorer than Japan was then, China is already America's fastest-growing export market. And in contrast to the 1980s, the WTO now exists as an umpire for trade disputes. But logic, alas, may count for less than political grievance. America's low unemployment rate looks set to rise in the wake of the housing bust. To American voters, the Chinese are likely to become more prominent rivals, whether it be displacing America at the top of some economic league tables, winning Olympic medals or buying big American firms (the Chinese are rightly keen to diversify from treasury bonds). Most worrying, though, are the strategic risks. Japan was an ally in Asia: China is potentially a military competitor. Trade tensions could make it easier to see China as a rival and harder to enlist it as a partner.

Running such geopolitical risks would be understandable if China's policies posed a true threat to America's economic health. But they do not. China's intellectual-property violations cost American firms far less than many would have you believe: pirated DVDs may sell for peanuts in the markets of Shanghai, but if Hollywood tried to sell the genuine articles at full price, it would quickly discover that most Chinese could not afford them. Similarly, a stronger yuan would do little to dent America's trade deficit (see [article](#)).

## So much to lose, so little to gain

The bilateral trade imbalance, the target of so many American politicians' anger, is an economic red herring. Its rise reflects changing supply patterns in Asia: America now imports more stuff that has passed through China—and correspondingly fewer goods from South Korea and Taiwan. China's overall surplus and America's overall deficit have less to do with the value of the yuan than with Chinese saving and American profligacy. True, a stronger, more flexible yuan makes sense for China, because it would help shift spending towards imports and would give Beijing's policymakers greater control over interest rates, making it easier to prevent the economy from overheating. But the effect on America would be small.

Rather than picking fights over the currency, Congress should step back and ask why Americans are so upset with China in the first place. The answer is that China is a scapegoat for broader economic anxieties to do with stagnant wages, rising income-inequality and dwindling health and pension benefits. These insecurities, which also lie behind the bad idea of introducing labour standards in trade agreements (see

article), are much better tackled head on—at home.

Comprehensive health-care reform to create a system where all Americans have access to portable health insurance would do a lot to reduce workers' anxiety and equip them for an economy that these days demands frequent job shifts. Reform of the payroll tax, a regressive levy that hits the less affluent hardest, would be a good way to shift resources to needier Americans. By contrast, raising barriers to cheap Chinese imports would disproportionately hit the wallets of poor and middle-income American consumers—the very people the Democrats in particular claim to be protecting.

By scaling back its China-bashing, Congress could avoid such blunders. It would also leave more room to engage Chinese officials on subjects that actually matter. Top of the trade agenda ought to be the successful conclusion of the Doha round of global talks. No country has more at stake in a vibrant WTO than China, yet Beijing has been scandalously unwilling to help push for a Doha deal.

But the greatest prizes of Sino-American diplomacy are nothing to do with trade. Avoiding war and conflict, naturally, comes top of the list, whether by co-operation over North Korean and Iranian nukes or by building the trust that minimises the odds of a clash in the Taiwan Strait. Then there is China's expansion into Africa, particularly its cosy relations with genocidal Sudan. Global warming, too, ought to be centre-stage. China is building a new coal-fired power plant every week and is set to surpass America as the biggest source of greenhouse gases within a year. If the world is to contain its carbon emissions, America must not only clean up its own act but also help China to green its economic growth.

Mr Paulson wants the strategic dialogue to address some of these broader issues. Congress should stop distracting him.