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Book review by Edward Luce

CHINA – THE BALANCE SHEET
Institute for International Economics and the Center for Strategic and International Studies, Public Affairs
New York, $25

If America's angst about globalisation could be reduced to one word it would be "China". Walk around a Wal-Mart superstore and every other product is made in China. Ask why Americans are so jittery about their job security – despite having near full employment – and most give the same answer.

The data bear out many of these fears. China's $202bn (£115bn) trade surplus with the US accounted for 27 per cent of America's current account deficit in the past year, up from 18 per cent in 2000. China's heavy intervention in the currency markets to stem the rise of the renminbi against the dollar is almost as widely cited on Main Street as Wall Street. When China's reserves hit a trillion dollars ($1,000bn) later this year, late night talk shows will probably cite that number in their jokes.

So it is unsurprising that Capitol Hill, which faces mid-term elections in November, is threatening retaliatory measures against Chinese exports unless Beijing acts to reduce its growing trade surplus. The rising climate of Chinaphobia also promises interesting moments for Hu Jintao, China's president, when he visits the US next week.

But the steps under consideration by Congress, which include a punitive 27.5 per cent tariff on Chinese imports unless it sharply revalues its currency, would probably not achieve their intended results. As pointed out in China: The Balance Sheet – a timely book published this week by two leading Washington think-tanks – most of China's exports to the US originate from other low-cost economies. China is the final point of assembly. Almost two-thirds of China's exports to the US have an import component.

If Mr Hu were to accede to Washington's demands, China's revaluation would simply divert America's deficit to other Asian exporters. To stand any chance of denting the deficit and preserving China's competitiveness, there should be a broad-based currency realignment incorporating Japan, South Korea, Taiwan and Hong Kong. Even then, a 20 per cent co-ordinated appreciation would only reduce America's deficit by about 10 per cent, according to the authors.

The more closely the problem is dissected, the more distant a practical solution becomes. At its root is the fact that America's net domestic savings rate is hovering at just above 1 per cent of gross domestic product while China's is above 40 per cent. In short, America consumes more than it produces and China produces more than it consumes.

In the absence of counter-balancing Chinese measures, any action by the US to raise its domestic savings – by cutting its budget deficit, for example – would risk a US recession.

Meanwhile, embarking on mutually balancing steps, in which China imported more US goods to ease the corresponding reduction in US demand, would only work if it were sustained and far-reaching.

Leaving aside the irony that a Republican administration is urging higher welfare payments on a communist government, China, in any case, would need to create a social safety net to assuage growing inequality.

But it is one thing to recommend that China boost domestic demand by raising social spending. It is quite another to expect China will easily be persuaded to take the huge dollar losses that would result from a sharp revaluation of the renminbi.

Likewise, Washington has legitimate concerns that an abrupt dollar depreciation could pop the US housing bubble. Rising home prices have underpinned America's robust levels of domestic consumption, which in turn have sustained economic growth.

Against this, the authors have some reassuring insights. They dispute, for example, the widespread view that US interest rates would shoot upwards if China sold off a large chunk of its Treasury bonds. They estimate the net impact of Chinese dollar purchases on US long-bond yields at only 25 basis points.

They also remind us what happened the last time America got steamed up about unfair competition during the phase of "Japanic" in the late 1980s. Since 1994, Japan's share of world manufacturing has fallen from 24 to 21 per cent while that of the US has stayed constant at 24 per cent.

That US protectionists cried wolf before does not mean they are wrong about China on all points. But as this book persuasively argues, it is in America's interests to coax rather than confront China. The two share a strong interest in reducing global imbalances together in an orderly and calm fashion. Meanwhile, American job insecurity can more squarely be blamed on the country's underperforming high schools. But Mr Hu cannot be expected to have an opinion on everything.

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