US-China trade tensions escalate

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10 April 2006

In the lead up to the visit by Chinese President Hu Jintao to the US on April 20, a renewed debate has erupted in the US Congress over demands for punitive trade measures against China. While the immediate legislative push has been delayed, there is no doubt that President Bush is under considerable pressure to exact significant economic concessions from his Chinese counterpart.

Two US Senators—Charles Schumer, a Democrat from New York, and Lindsey Graham, a Republican from South Carolina—sponsored a bill that threatened to impose 27.5 percent of tariffs on Chinese exports if Beijing failed to revalue the yuan. While a vote had been scheduled for March 31, Schumer and Graham backed off, for the time being, after a trip to China last month during which Chinese officials promised further reform on exchange rates.

Last July, in response to US pressure, Beijing formally abandoned pegged rates between the yuan and the US dollar. But the Chinese central bank has maintained the currency within a narrow range of around eight yuan to the dollar. Dissatisfied sections of the US Congress and business argue that the move was far from sufficient to "correct" the huge US trade deficit with China. They accused Beijing of artificially depressing the yuan by up to 40 percent, giving Chinese exports an "unfair" competitive edge.

The US trade deficit with China ballooned to more than $200 billion last year and the overall US current account deficit reached $805 billion. By the end of February this year, China overtook Japan as the world's largest holder of foreign currency reserves—$US853.7 billion, mostly from Chinese central bank purchases of US Treasury notes and other dollar-based assets. By the end of this year, China's foreign currency reserves are likely to hit the $1 trillion mark—as will the US current account deficit.

As China has become a global economic force, Sino-US relations have become more complex, creating rifts within the American ruling elite. Many US corporations are using China as a cheap labour platform and have large investments there. Their concern is that US trade sanctions against China would hit their profits while doing little or nothing to alter the trade deficit. Less competitive layers of business, backed by the trade union bureaucracy, have lobbied hard to block cheap Chinese exports, blaming them for the decline of US manufacturing and the loss of jobs.

For the Bush administration, the issues are strategic as well as economic. In the long term, it continues to regard China as "a strategic competitor" and has pursued an encirclement policy of establishing military bases and alliances with China's neighbours. In the short term, however, Beijing has proven a useful ally in the bogus "war on terror" and in exerting pressure on North Korea to come to the negotiating table. Moreover, any move in Beijing to stop or even slow its buying of US dollars would have immediate repercussions for the US economy, possibly plunging it into recession.

As a result, the Bush administration has been engaged in a balancing act, seeking to get as many economic and other concessions from Beijing as possible, without precipitating an escalating trade conflict. During a visit to Beijing, US Commerce Secretary Carlos Gutierrez warned on March 30: "It is important for our colleagues in China to recognise that the voices in the US calling for protectionist policies are real."

Just hours later in Washington, treasury undersecretary Timothy Adams told a Senate hearing that China had been "far too cautious" in moving towards flexible exchange rates. At the same time, however, he made clear that the Bush administration opposed discriminatory tariffs on China as outlined in the Schumer-Graham legislation. "There are several bills in Congress that would close our markets to Chinese goods if China does not move more its exchange rate. We do not support those isolationist approaches. They would damage our economy and not achieve our shared goals," he declared.

Instead the Bush administration has backed a new bill introduced by Republican Senator Charles Grassley—the chairman of Senate Finance Committee—and Max Baucus, the committee's leading Democrat. Though less extreme and with fewer immediate consequences than the Schumer-Graham bill, the alternative legislation may well have more far-reaching implications by imposing sanctions against countries found to have "currency misalignments" with the US.

To date the US Treasury has rejected demands by US lawmakers to brand China as a "currency manipulator" under the terms of a trade law passed in 1988. Under the current rules, the Treasury can avoid naming China as a currency manipulator because Beijing maintains fixed exchange rates, rather than "intending" to undervalue its currency. Moreover, in 1994, when the Clinton administration named China, Taiwan and South Korea as "currency manipulators", it had few actual consequences.

Under the Grassley-Baucus bill, however, "currency misalignments" would require no intention on the part of a foreign government. The legislation would give the nominated country six months to correct the "misalignment" or face a range of penalties, including tariffs as allowed for under World Trade Organisation (WTO) rules.

The US thinktank Stratfor noted that the latest bill was a compromise between the Congress and the White House. "Bush does not have to crack down on China to maintain his own standing within the Republican Party. If the Graham-Schumer bill had been voted on and passed, Bush would have had no choice but to address the sentiment and take a hard-line stance against China during his visit with Hu. Polls indicate Bush is facing a legitimacy crisis, and despite the administration's reluctance to act against China, he would have been forced to side with his party. Now, the administration has some breathing room," it wrote.

Although the new bill is unlikely to be voted on before the Chinese president's visit, protectionist sentiment in Congress remains strong. In a show of commitment to act against China's "unfair" trade, the Bush administration on March 30 joined with the European Union (EU) to challenge China before the WTO over its "illegal" high tariffs on imported auto parts. Brussels and Washington have given Beijing 60 days to settle the dispute or face further action. Senator Baucus has welcomed the step but provocatively warned: "We are in a dangerous place in our relationship with China, partly because China does not always play by the rules."

US financial commentators have expressed nervousness about the prospects of trade war with China. An article of the British *Observer* on March 26 cited Philip Swagel, an analyst from American Enterprise Institute. He likened the Graham-Schumer legislation to Smoot-Hawley Act in the 1930s which produced competing trade blocs and trade conflict. Swagel warned that if tariffs were imposed on China, Schumer "would go down in history as the man who crashed the US economy."

An editorial of *Los Angeles Times* on March 24 denounced the campaign for the revaluation of the yuan as "absurd". It declared: "Even if its currency appreciated, China would still be able to produce goods far more cheaply. And if it appreciated significantly, the winners would likely be other suppliers, such as Vietnam or Indonesia, not manufacturers in upstate New York... The economic relationship between the world's richest nation and its most populous one is extremely positive on the whole—with Chinese savers underwriting our lavish lifestyle by buying Treasury notes. A capricious 27.5 percent tariff would surely poison a well we've grown to depend on."

These comments underscore the enormous contradictions of the world capitalist economy, which finds its sharpest expression in the economic interdependence between US and China. US transnational corporations invest in or outsource to China to exploit its cheap labour to offset declining profitability. The US is both the world's largest consumer market and the biggest debtor nation. Chinese and other Asian central banks have bought massive amounts of dollar-denominated assets, ensuring the US economy continues to grow and absorb Asian exports. Some analysts estimate that $3 billion in foreign funds are flowing into the US every day.

The situation is further complicated by the rise of euro as a competing world currency. Although the EU is also demanding a revaluation of yuan, European interests conflict with those of the US. Before an EU finance ministers meeting in Vienna on April 7, the European Commission has produced a paper pressing China for greater flexibility of exchange rates but "in a gradual manner". It warned that a sudden revaluation of the yuan against the US dollar could add to greater downward pressure on the dollar against the euro, hurting European exports and economic growth.

As for China, the Beijing bureaucracy is acutely aware that its "economic miracle" is dependent on the continued huge flows of investment into the country and the maintenance of large export markets in the US and Europe. Any economic instability would immediately lead to escalating unemployment and further inflame social tensions. While in the US, the Chinese president is expected to sign agreements to buy 80 Boeing planes worth $6 billion, in an effort to appease the US Congress over trade issues. However, this is just a drop in the ocean.

The US has no solution to its declining economic position, other than continuing to borrow at an even higher rate from foreign sources. Even without a politically provoked trade crisis, these processes cannot go on indefinitely and must eventually reach a breaking point—with devastating consequences for the US, Chinese and world economy.