US-China trade tensions set to escalate

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From the outset, the Obama administration has signalled a more confrontational approach to Beijing. Last month, President Obama's nominee for Treasury Secretary, Timothy Geithner, testifying before US Senators, accused China of keeping the yuan, or renminbi, artificially weak in order to undercut its foreign rivals. On January 26, the Senate confirmed Geithner's appointment by a vote of 60-34, suggesting strong support in the Congress for his aggressive stance.

If Geithner designates China a "currency manipulator" in an international currency report due in April, it will allow the US administration to demand that Beijing end its tight control over the yuan. If Beijing failed to do so, Washington could introduce punitive tariffs and other trade measures against China, possibly leading to a full-scale trade war.

Under mounting international criticism over the provocative US stance, Obama called President Hu Jintao last Friday in an attempt to defuse the tensions. Despite a reportedly cordial exchange about the importance of the US-China relations, Obama stressed the need to correct global imbalances, a phrase that refers to the huge US trade deficit with China. Hu, in turn, emphasised the need to oppose protectionism, a warning directed at the US.

During the US presidential campaign last year, Obama declared in his China policy statement: "Central to any rebalancing of our economic relationship with China must be change in its currency practices. Because it pegs its currency at an artificially low rate, China is running massive current account surpluses. This is not good for American firms and workers, not good for the world, and ultimately likely to produce inflation problems in China itself."

Apart from representing a more strident foreign policy, Obama's protectionism partly reflects the fears of less competitive US companies in industries such as steel, auto and textile that are vulnerable to global competition, and the associated trade union bureaucracy. Obama's Republican rival, John McCain, was more in line with the Bush administration's policy of avoiding a direct confrontation over China's currency, primarily out of a concern to protect American business interests in China.

China officially ended its decade-long yuan-dollar peg in 2005, due to pressure from the Bush administration for more "flexible" exchange rates, but continued to maintain tight control over the currency in order to keep Chinese exports competitive. At the same time, the yuan's gradual revaluation of 20 percent over the past three years generated enormous pressure on Chinese exporters, even before the collapse of the foreign orders in recent months. Amid escalating job losses and the prospect of social unrest, there are mounting calls within China for the government to devalue the yuan. By last November, 20 million rural migrant workers in China had already lost jobs, with new estimates pointing to 40-50 million more in 2009. These figures do not include millions of unemployed urban workers.

At the World Economic Forum in Davos last Wednesday, Chinese Premier Wen Jiabao blamed the US for "excessive expansion of financial institutions in blind pursuit of profit" and "lack of self-discipline among financial institutions and rating agencies" for the present global economic crisis. While not naming the Obama administration, Wen declared: "Protectionism serves no purpose except to worsen and prolong the crisis."

Leading economists at the conference expressed deep concerns about the US threat to list China as a currency manipulator. Stephen Roach, the Asia chairman of Morgan Stanley, said: "I have never seen an economy entering recession raise the value of its currency. It would be an economic suicide." Roach estimated that the Chinese economy was actually contracting in the last and current quarters. He observed that as many as 45 pieces of legislations had been proposed in the US Congress in recent years, mainly by the Democrats, threatening to impose trade sanctions on China.

The US-China tensions have raised fears that Beijing could dump its US assets of more than $1 trillion, precipitating a devastating collapse of the dollar. A *Financial Times* editorial on January 26 said Geithner "was playing with fire" by accusing China of being a currency manipulator. "It could provoke China into a sudden and dramatic readjustment of its exchange rate and foreign reserves management—up to and including its willingness to hold US sovereign bonds." The Bloomberg web site warned: "It's hard to believe that Geithner hasn't stressed the dangers of a trade war with the largest holder of US government debt. Federal Reserve Chairman, Ben Bernanke, a Great Depression scholar, is sure to advise against policies that inhibit growth."

Significantly, the *Wall Street Journal* on January 26 defended China's currency regime: "The dollar-yuan link [established in 1994] allowed a real price system to arise in China and created a single economic fabric stretching across the Pacific. Before long, the whole region had adopted what Stanford economist Ronald McKinnon calls the East Asian Dollar Standard. The opposite of currency ‘manipulation', this dollar standard was a victory for free trade and global growth. But the US economists missed its portent."

Many Asian countries peg their currencies to the US dollar in order to maintain export competitiveness. Recalling the boom prior to the current meltdown, when China enabled major US corporations to gain "most of the world's profit and wealth", with US consumers "benefiting" from low-cost imports, the *Wall Street Journal* insisted that the US trade deficit with China "was perfectly natural".

The newspaper criticised the Bush administration and former Fed chairman Alan Greenspan for implementing an easy money policy with low interest rates, leading to debt-driven economic expansion and its collapses. This argument simply ignores the fact that the Wall Street financial plutocracy created and profited from the vast and unsustainable growth of fictitious capital. The Bush administration resisted the pressure from the US Congress to name China as a currency manipulator in order to maintain the inflow of the Chinese money, which has been a critical component in propping up this financial house of cards.

A significant proportion of Chinese goods is manufactured on behalf of US corporations, boosting their profit rates and temporarily sustaining the consumption of American workers despite declining real wages. More importantly, China's expanding trade surpluses became a major source for buying US Treasury bonds, helping finance the US trade and balance of payment deficits. China and Japan alone hold a quarter of the $5.8 trillion outstanding US government debt. The flow of cheap credit and low-price goods from Asia helped the Federal Reserve Board maintain a low interest rate policy, thus providing the basis for Wall Street to create ever bigger debt and credit bubbles and creating an expanding market for industries in China, including those run by US firms.

The opening up of China as a giant cheap labour platform over the past 30 years was vital for world capitalism to counter falling rates of profit and force Western workers to accept lower wages. Four million manufacturing jobs in the US were destroyed during the past eight years, largely due to the brutal exploitation of labour in China and other developing countries by the transnational corporations. The mirror opposite in the US was the vast expansion of financial parasitism and industrial decline, which ultimately led to the crash of 2008, and the loss of another 2.6 million jobs so far.

Now, in order to make China a scapegoat for rising unemployment in the US, Washington has attacked Beijing in the World Trade Organisation (WTO). Last week, the US claimed a victory over China after the WTO ruled that China had violated its obligations to protect US intellectual property rights in movies, software and other branded items. In another case filed in December, the US accused China of violating global free trade by operating a "famous brand" program to promote Chinese exports, with more than 70 subsidies, giving them "unfair" advantages.

China's own protectionism is rooted in the fear that its dramatically slowing economy will cause a social explosion. Beijing reintroduced tax rebates in November for some 3,000 export items in order to expand China's share in the shrinking global markets. Amid falling rural incomes, Beijing also moved to restrict agricultural imports, which must exacerbate tensions with other countries, especially the US.

Russell Leigh Moses, an analyst at the Beijing Centre for Chinese Studies, told the *Christian Science Monitor* last month: "The leadership here is under enormous pressure from manufacturers and local officials to do whatever it takes to save jobs and maintain stability. There are some voices within the bureaucracy who are concerned about this ‘China first' strategy, but they are being overwhelmed by these domestic cries for help."

This "China first" strategy will inevitably drive Beijing into conflict with Washington's "Buy America" push and similar protectionist measures in other countries. As in the 1930s, the trade tensions between the major capitalist powers have the potential to trigger more dangerous forms of conflict, including full-scale war.