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Insight: What a stronger Chinese yuan means for the U.S.

Wed, Oct 5 2011

By [Emily Kaiser](#), Asia Economics Correspondent

(Reuters) - A sharp rise in China's yuan currency might cut the U.S. trade deficit by as much as one third and create enough American jobs to put at least a modest dent in the unemployment rate.

Then again, it may also lead to a destabilizing spike in Chinese unemployment and spark a trade war that drags the global economy back into a deep recession.

These are the conflicting forces U.S. lawmakers must consider as they decide whether to pass a bill which would pressure Beijing into letting its currency rise more rapidly.

The debate over whether China's currency is undervalued is essentially closed. Beijing readily acknowledges that a gradual yuan appreciation is in its best interest, and it has allowed the currency to rise by about 6.5 percent since June 2010.

Where the disagreement lies is how far and how fast the yuan ought to appreciate.

"The Chinese will scream, but the only times they've let their currency rise is when they're under pressure from the outside, so we should go ahead and do it," said Fred Bergsten, director of the Washington-based Peterson Institute for International Economics and a long-time critic of China's currency policy.

Bergsten is among the most vocal proponents of increasing the pressure on China, arguing that an undervalued yuan gives it an unfair trade advantage which harms the U.S. economy.

He estimates that a 20 percent rise in the yuan would reduce the U.S. current account deficit by \$50 billion to \$100 billion. A more extreme move, say 40 percent, would translate into as much as a \$200 billion reduction.

About half of that would come from increased exports, mostly to China but also to other countries where China is now the dominant trade player. The other half would come from reduced imports from China.

The United States gains about 6,000 jobs for every \$1 billion improvement in the trade balance, so \$100 billion would work out to 600,000 jobs, he said. That is more than the anemic U.S. economy has generated in the past six months combined, and would be enough to shave about four-tenths of a point off the 9.1 percent jobless rate.

Bergsten's view is not universally shared.

Some economists argue that a stronger yuan would simply shift manufacturing to other low-cost producers such as Bangladesh or Vietnam, and the United States would still be uncompetitive.

"An appreciation of the yuan against the dollar would indeed reduce the U.S. trade deficit with China, but it is unlikely to have a major effect on U.S. job creation," said Eswar Prasad, a former International Monetary Fund official who now teaches international trade policy at Cornell University in New York.

China's state-owned Xinhua news agency was also dismissive of job creation claims.

"There has been no evidence to prove the link, claimed by the U.S. lawmakers, between China's exchange rate and the U.S. unemployment," Xinhua said in an English-language commentary published on Tuesday, adding that Washington "has to share a great part of the blame" for the trade imbalance.

The 2011 U.S. trade deficit was \$428 billion through July, up from \$367 billion over the same period in 2010, according to U.S. Commerce Department data.

China accounts for about 37 percent of the 2011 total.

THE FLIP SIDE

For China's economy, a stronger yuan would reduce economic growth and increase unemployment, although there is a wide range of opinions among economists as to the magnitude.

Deutsche Bank economist Jun Ma examined this in June 2010, when China relaxed its grip on the yuan. His study showed that a 10 percent yuan appreciation would reduce real gross domestic product by 0.6 percent, a relatively modest hit in an economy growing at more than 9 percent annually.



Ma's figures suggest a stronger yuan would increase unemployment by 0.4 percent, which amounts to about 3 million jobs in a work force of 780 million. Real exports would likely fall by 2.5 percent while imports would increase 1 percent.

Xiaohu Zhang at the University of Newcastle in Australia wrote a paper in 2006 looking at the effects of yuan revaluation. His findings indicated a 20 percent yuan rise would trim about 12 percent off of China's annual GDP.

The yuan exchange rate is the clearest manifestation of a currency policy that is anything but simple. For Beijing, the yuan's value is not just about fiscal policy. It is critical to social stability as well.

China's exports totaled \$1.58 trillion in 2010, according to the International Monetary Fund, or about one-third of its gross domestic product. That's nearly three times the share that exports comprise in the United States.

The factories that fill those shipping containers with shoes, laptops, furniture and food employ millions of rural workers who migrate to China's cities each year.

That is the primary reason why Beijing has no interest in speeding up the pace of the yuan's rise. Indeed, it pulled back on the rate of appreciation in September when fears intensified that the global economy could be heading toward a recession.

Yet China has a vested interest in a stronger yuan.

It would help to tamp down inflation, which stood at 6.2 percent year over year in August, far above Beijing's 4 percent annual target. It would also boost households' buying power, which is vital to achieving China's goal of developing a more consumer-driven economy.

But when the directive comes from Washington, China's response is typically prickly.

Part of the reason for that is a widely shared belief in China that the industrialized nations, threatened by China's swift rise, want to hobble its economic fortunes.

Many commentators point to the Plaza Accord of 1985, when the United States and other governments engineered a sharp depreciation of the dollar against the Japanese yen and German mark. China could become the next target of such a move, the thinking goes.

"The Plaza Accord was in essence an American conspiracy," said a recent commentary in the Legal Evening News, a Chinese tabloid, which was circulated on many Chinese news websites.

"Whenever a country's level of development and foreign exchange reserves reach a level that makes the United States feel uneasy, letting the dollar depreciate has been a consistent U.S. response. Now that pressure has shifted to the world's second biggest economy, China."

WHO BENEFITS?

Beijing is well aware that Japan fared poorly after the Plaza Accord.

The stronger yen discouraged investment and "crushed the economy," said Ronald McKinnon, an economist at Stanford University in California.

"The only thing that didn't fall was their trade surplus," he said. "This could happen to China."

Tokyo's attempts to reinvigorate the economy after the Plaza Accord have since been blamed for inflating an asset price bubble that eventually burst, plunging Japan into a deflationary spiral that it is still struggling to break.

The lesson from Japan, McKinnon argues, is that a stronger yuan may not have the desired effect if it weakens China's economy so severely that demand for U.S. goods falls.

Researchers at the Carnegie Endowment for International Peace drew a similar conclusion in a report released in December: a stronger yuan would widen the U.S.-China trade deficit because the rise in the price of imports from China would outweigh any gain in exports.

To be sure, some of China's neighbors would stand to benefit if the yuan rose significantly. Nations such as Vietnam which emulated the Chinese export model as a way to speed up economic development might see more business swing their way.

But China itself has become a vital trading partner for other Asian countries. It is the top export destination for economies including South Korea, Taiwan and Malaysia.

Even for the United States, China is becoming a bigger export market. In dollar terms, the United States imports almost four times as much as it ships to China, but exports are growing more rapidly than imports.

That is why some U.S. business groups have voiced strong opposition to the currency bill, echoing China's stern warning that Congress risked touching off a trade war.

"A trade war is all that is missing to complete the parallels between the U.S. economy of today and that of the early 1930s," said Tim Condon, an economist with ING in Singapore.

(Reporting by Emily Kaiser in Singapore; Additional reporting by [David Lawder](#), [Pedro Nicolaci da Costa](#) and [Jason Lange](#) in Washington, [Chris Buckley](#) in Beijing; Editing by [Dean Yates](#) and Neil Fullick)

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