

<http://news.bbc.co.uk/2/hi/business/4925380.stm>

What is America's China Problem?

Analysis

By Steve Schifferes
BBC News economics reporter

20 April 2006

Strained trade relations between the US and China are dominating talks between US President George W Bush and Chinese President Hu Jintao in Washington.

The US fears China's fast-growing exports will hit American jobs.

US manufacturers claim that China's undervalued currency is to blame.

But China is also a growing market for US goods, and many US firms are also direct investors in Chinese factories.

So how justified are the US complaints?

Mutually beneficial

In theory, both China and the US agree that free trade between the countries will be of long-term benefit to both - a view exemplified by China's entry into the World Trade Organization in 2001.

President Hu endorsed this view when he visited a Boeing factory, saying it was "a living example of the mutually beneficial co-operation and win-win outcome that China and the United States have achieved from trade".

But despite China's recent trade deals with Microsoft and Boeing, the country's huge trade deficit with the US soared to more than \$200bn (£112bn) in 2005.

And as China's trade surplus has grown, it has become one of the largest buyers of US Treasury bonds, which help fund America's large budget deficit.

Currency manipulation?

Many in Washington DC are convinced that unfair Chinese trading practices are behind these figures.

SINO-US TRADE ISSUES

The US had a \$202bn trade deficit with China in 2005

The US is China's second largest trade partner, while China is the US's fourth largest market

The US has restricted Chinese exports of textiles and clothing
The US says big revaluation of the yuan is needed

The US has pushed for restrictions on Chinese textile exports, which were imposed last year, and now many US manufacturers insist that China has undervalued its currency to keep its manufactured exports cheap.

They argue that China should increase the value of its currency, the yuan, by up to 40% to restore the competitiveness of US goods.

Beijing - which raised the yuan's value against the dollar by 2% last year - has denied claims of currency manipulation and says it will introduce a free-floating currency only gradually.

Now, however, the US position has been given partial support by the World Trade Organization (WTO), which says currency reform could help ensure China's boom does not get out of hand.

In its trade review of China, the WTO says: "A more flexible exchange rate could enable China to operate a more independent monetary policy, which would be better suited to ensuring a low and stable rate of inflation."

Global imbalances

However, it is unlikely that either side can really move quickly on this issue.

A big revaluation of the yuan would upset many of China's foreign investors, who would suddenly find it much more expensive to build or buy factories there.

That could trigger a sharp slowdown in China's rate of economic growth, which is dependent on exports.

Nor would the US unambiguously benefit from such a move.

The currency realignment, if financed by the sales of US Treasury bonds, could trigger a run on the US dollar - a sharp fall in its value.

For too long, Senator Chuck Grassley told me, there has been a "namby-pamby" attitude to getting tough with the Chinese... the time has come for real tough talk

That, in turn, could mean higher inflation and higher interest rates in the US.

Many economists argue that any currency realignments would have to be gradual, managed and global, involving not only China but other Asian currencies and the euro too.

Trade rows

Meanwhile, the trade rows between the US and China are likely to continue.

The WTO's report has given plenty of ammunition to US arguments that China has not yet fully embraced open trade commitments, such as non-discrimination against foreign companies and fair and open enforcement of trade law.

The WTO says clearer investment and trade guidelines are needed to ensure a level playing field between state and private enterprises, and says that China continues to manage trade to ensure domestic supplies.

Intellectual property rights are also a continual source of friction between the US and China.

(Further growth) may require a reappraisal of current policy of giving priority to attracting investment in export-oriented, capital-intensive manufacturing

World Trade Organisation

"Effective enforcement of intellectual property rights is also needed to ensure an investment environment conducive to the development of innovation and foreign investment," the WTO notes.

Amidst the rows, China continues to play a key role as the Doha round of global trade talks enter a critical phase.

The US and the EU are pressing the fast-growing economies like China, India, and Brazil to open their manufacturing and service sectors further to Western goods in return for the liberalisation of agricultural trade, but they have formed a united front known as the G20 to argue their case.

Domestic rebalancing

And the WTO notes that in the long term, the future economic development of China will probably require a shift from export-oriented manufacturing to service sector growth.

Such a shift would boost the domestic economy and would help absorb the millions flooding into China's cities in search of work.

It said that future growth "may require a reappraisal of current policy of giving priority to attracting investment in export-oriented, capital-intensive manufacturing."

But the US will also have to address competitiveness issues of its own, including the effect of the huge budget deficit on domestic investment, in order to lower its trade surplus - which is not only with China.

For both countries, such decisions would require painful adjustments that could threaten key domestic constituencies.

For the time being, rhetoric is likely to prove much easier than action.

Story from BBC NEWS:

<http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/4925380.stm>