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### **Arcane Currency Battle Masks Deeper Economic Tensions with China**

Reporting from Washington

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For much of the last decade, the economic relationship between the United States and China was like a bartender and his favorite patron. American consumers knocked back flat-panel TVs, laptops and lots of other made-in-China products while Beijing rang up the charges, but extended more and more credit so the customer could keep drinking.

On paper, the Chinese accumulated hundreds of billions of U.S. dollars. But instead of cashing in its horde, China loaned much of it back to Americans to help finance ever-higher consumer borrowing, as well as federal deficits and cheap mortgages.

It was a mutually beneficial arrangement while it lasted. But the Great Recession put that mountain of debt in a new, unsettling light. Now, the two partners are eyeing each other with growing resentment – each showering the other with unwelcome demands for policy changes.

And the tensions are being aggravated by domestic politics in both countries.

"The proverbial train wreck may be coming to pass," said Nicholas Lardy, a prominent China expert at the Peterson Institute for International Economics in Washington.

Chinese officials have begun to warn that, if Washington doesn't curb its rising deficits and stop badgering China to make concessions on currency and export policies, Beijing may begin dumping dollars. Or it might at least cut back on the massive buying of Treasury bonds that Washington depends on to finance its deficit.

Any such action could inflict economic pain on millions of Americans, costing jobs and hurting the recovery, some economists say.

But China is over a barrel too. If Beijing tightened the screws, the dollar would decline. The value of China's holdings would shrink. So would Americans' consumption of Chinese products. Even with the recession, U.S. imports from China amounted to a whopping \$296 billion last year, while exports to China were just \$70 billion, according to U.S. data.

Beijing has no ready replacement for the United States as its biggest customer. And

years of rapid growth and rising prosperity have created popular expectations in China that the ruling Communist hierarchy cannot easily ignore -- especially the opinions of its the increasingly vocal business community and middle class.

The basic issue is how to reshape the U.S.-China relationship on a more sustainable and balanced basis. And the process is almost certain to require uncomfortable changes on both sides.

But right now the historic drama is playing out in an arcane argument over currency exchange rates – the value of the yuan versus the dollar

Scores of U.S. lawmakers in recent days have demanded that China strengthen its currency, so its goods wouldn't be so cheap in U.S. and other foreign markets. Raising the value of the yuan could also encourage China to buy more American products.

"The silence of our government on China's currency manipulation has become the silence of our factories," said Sen. Olympia Snowe, (R-Maine), a senior member of the Finance Committee.

Outside Congress, leading free-trade proponents including Nobel laureate Paul Krugman have joined labor leaders such as Leo Gerard of the Steelworkers Union in denouncing Beijing's refusal to act.

Twice in the last two months, Obama has called on the Chinese to act on their currency. Each time, the president got a sharp, negative response.

"For the Chinese government, it's not only about losing face and confidence" if they bow to U.S. pressure, said Zhou Shijian, a senior research fellow at the Center for U.S.-China relations at Tsinghua University. "It's also about the economy."

"In 2009, exports dropped 16%. Appreciating the yuan will impact the economy and social stability, not just face," he said.

Outside of China, few dispute that the yuan is undervalued, and most say by 25% or more. But there are differences over how much even a big increase in its value would help employment in the U.S. – or hurt it in China.

[Drew Greenblatt](#), president of [Marlin Steel Wire](#) Products in Baltimore, calculates that he could double his company's payroll, to 60, if the Chinese currency rose by 25% or more against the dollar. That would more than offset the 10% to 15% cost disadvantage that [Marlin's wire baskets](#) currently have against made-in-China competitors.

Revaluing the yuan "would absolutely help my business," he said.

Krugman, the economist, estimates that China's currency policy – and resulting large trade surpluses -- may end up costing about 1.4 million jobs in the U.S. in the next couple of years.

But Lardy of the Peterson Institute calls that a "substantial overstatement" based partly on assumptions of China returning to a pattern of surging trade surpluses with the United States. During the 2008-09 recession, China's surplus fell sharply.

"The big question is whether the surplus continues to come down or rise back up," he said.

Assuming China and other Asian countries let their currencies rise 20%, Lardy estimates that would lead to a 3% decline in the value of the dollar against an average of other trading partner currencies.

By one rule of thumb, that would translate into only 450,000 jobs.

Beyond the specifics of currency values, many Americans see an opportunity to correct years of economic imbalances and return the United States to a nation that saves more, imports less and rebuilds its manufacturing strength.

With the exception of a couple of years, U.S. factory employment has been falling continuously since the late 1970s.

It's been the reverse for China. Growth in manufacturing has lifted millions out of poverty and catapulted the Middle Kingdom to global superpower status.

And Chinese officials are feeling pressure to maintain that growth – and not revalue the yuan.

Typical are small export-driven manufacturers such as Ada Dong. A revaluation, she said, could potentially devastate her baby-bottle company, which is only now beginning to recover recession-dampened sales in the U.S. and Europe.

"It's going to have a huge impact on price," said Dong, who heads marketing at Johnny Vico Infant & Gift Products. "That's the primary reason our customers come to us."

"The Obama administration is putting pressure on China because they're facing their own great pressure to create jobs," said Zhou, the Tsinghua University researcher. "But it's the same situation in China.

"For the U.S. to create two million jobs, they're hoping the [yuan] will appreciate 30-40%," he said, "But that would mean 20 million migrant workers would lose their jobs. The Chinese government is facing the same pressure."

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